

# *THE CANADIAN CHARTERED ACCOUNTANT*



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**Estate Planning**


**Impact of Taxation on Corporate Management**

**Alberta Oil and Gas Conservation Board**


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## The Credit Manager "takes" a loss

"Sit down, John." The Treasurer seemed almost too affable, and the Credit Manager felt uneasy as he took his seat. "John, I'm faced with a problem. Costs. We've got to cut them. So the Board has given me the chore of chopping. Nothing but essentials must remain. That," he concluded, "is where you come in."

"At least," the Credit Manager thought, "he didn't say it's where I go out!" Then he realized he hadn't been listening.

"—with Credit Insurance, we've been paying for protection where we haven't had any losses to amount to anything for years. I'll have trouble justifying this." The Treasurer looked reproachful.

"Justify Credit Insurance?" The Credit Manager spoke with an appearance of calm. "First, there was the matter of using our insured Accounts Receivable as collateral for that sizable loan last year." He smiled inwardly as the Treasurer looked away. "Then, there is the matter of our increased volume over the past four years. Next, our control of losses—" he stopped as the Treasurer held up a hand.

"John," the Treasurer sounded regretful, "you make an excellent case. Nevertheless, something's got to go. In your department, Credit Insurance is the only thing I can see that's—uh—expendable." He held up his hand again as the other seemed about to speak. "Now, if you could insure just our marginal accounts . . . But something's got to go!"

The Credit Manager looked ruefully at the man from American Credit Indemnity. "Sorry to bend your ear this much," he apologized.

The American Credit man looked thoughtful. "I'm not sorry at all," he said, "because I'm sure we can help you. Not by accepting only your marginal accounts, because that would not be good for you or us. But simply by raising your primary loss."

"Raising our loss? Good grief, Joe, I couldn't agree to a thing like that!" The Credit Manager sound anguished.

The American Credit man was amused at the other's reaction. "The expression isn't 'loss', John, it's 'primary loss'. By raising your primary loss, we can reduce your premium, and you'll still be getting protection where you need it most: on all amounts above—say, twenty-five thousand dollars."

"Hmm! I never thought I'd be glad to accept anything higher than the word 'loss' in it, but this sounds like a good solution, Joe!"

\*\*\*

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## THE BANK OF NOVA SCOTIA



# THE CANADIAN CHARTERED ACCOUNTANT

VOL. 69, NO. 4, OCTOBER 1956

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*Opinions expressed are not necessarily endorsed by The Canadian Institute of Chartered Accountants*

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## IN THIS ISSUE

**F. S. CAPON, C.A.**

In "Impact of Taxation on Corporate Management" Frank S. Capon advances the theory that throughout business, the importance of having a sound knowledge of tax laws and maintaining clear and accurate records of all transactions cannot be over-emphasized. According to Mr. Capon, businessmen should also have good relations with government tax departments and maintain personal integrity in the handling of all tax matters within their own companies. The author explains why he rates these principles so highly and follows up his discussion by touching on some of the more unusual tax implications and types of company transactions.

Mr. Capon makes his points from first hand knowledge of the subject. He is presently secretary and treasurer of Du Pont Company of Canada Limited and formerly treasurer of Canadian Industries Limited. He has been a member of the Quebec Institute of Chartered Accountants since 1938 and is a past director of the Controllers Institute of America. Mr. Capon is a frequent contributor to *The Canadian Chartered Accountant*.

**N. A. MACLEOD**

The Canadian oil industry, with consumer demand for petroleum products keeping pace with accelerated business activity, continues to contribute to a broad and record breaking advance in the Canadian economy. Oil consumption-production reports show that Canadian crude

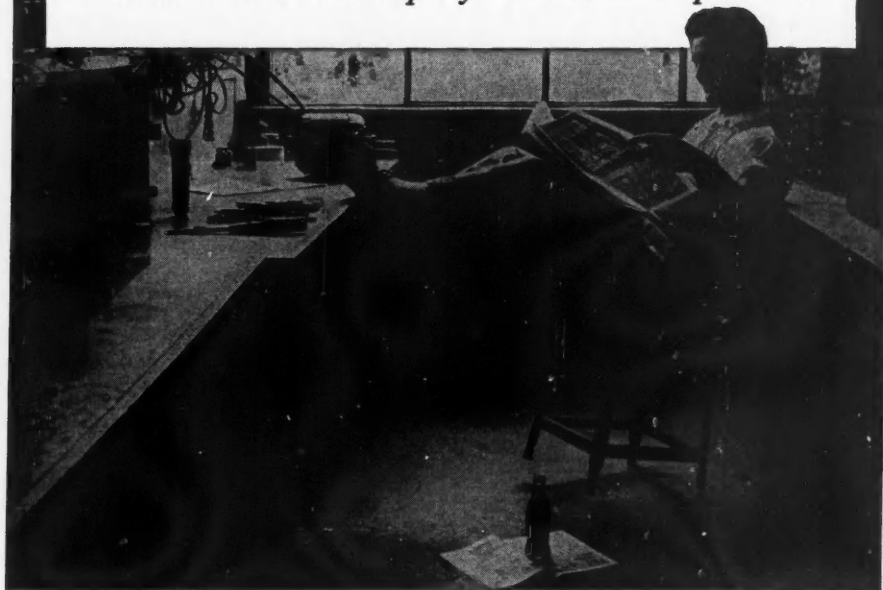
oil is becoming increasingly important and that it will be really crucial in years to come. The role of the Petroleum and Natural Gas Conservation Board of Alberta in promoting good operating practices and guiding the great expansion of the Province's oil and gas industry is discussed by N. A. Macleod, solicitor with the Board. Mr. Macleod joined the Petroleum Board in 1955 after six years with the Province of Alberta Mines and Minerals Department. The well licensing system enables the Board to keep track of all drilling operations and a competent field staff make regular inspections to see that all operations are carried out safely and efficiently. "The Board provides a repository of information about oil and gas in Alberta that alone could justify that body's operation" says Mr. Macleod who also states that a look at the Board's policies regarding gas conservation would facilitate the understanding of its gas pipe line problems. "The Role of Alberta's Petroleum and Natural Gas Conservation Board" is a full and up-to-date report on the functions of the Board.

**A. J. LITTLE, F.C.A.**

The accountant, because of his financial training and work in the field of taxation, is a logical and vital member of the estate planning team. Practically everyone with an estate over \$50,000 has an estate or succession duty problem of some sort and the role of the accountant in guiding and advising his client through the complexities of estate planning should be a most rewarding one. In "Estate Planning", A. J. Little discusses some of these problems to remind accountants of the scope that is open to them. He examines some of the techniques to illustrate what can be accomplished in determining the possible

*Continued on page 286*

*This man costs the company more than the president*



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*Continued from page 284*

minimum as well as maximum taxes that may be imposed.

Mr. Little is a partner of Clarkson, Gordon & Company, Toronto, a past president of the Toronto Community Chest and currently president of the Toronto Board of Trade. He obtained his certificate in chartered accountancy in 1938 and this year was admitted as a Fellow of the Institute of Chartered Accountants of Ontario.

#### J. E. LANGDON

One of the primary considerations in the sale or purchase of a business is how the buyer and seller will be affected by taxation when the deal is completed. The main consideration is whether both parties can work out a satisfactory and favourable arrangement whereby the levels of taxation can be kept within reasonable limits. John Langdon, who has had considerable experience in this field, discusses some of the problems in "Tax Aspects of Buying and Selling a Business". Mr. Langdon is a director of McLeod, Young, Weir & Company Limited and a partner of McLeod, Young, Weir & Ratcliffe, member of the Toronto, Montreal and Canadian Stock Exchanges. He was formerly Montreal Editor of the *Financial Post*, specializing in public utilities and the pulp and paper industry.

A second article by Campbell W. Leach, C.A. will appear in the next issue. He will deal with the principal items under the Income Tax Act when a business is sold. Mr. Leach is a partner of McDonald, Currie & Company, Montreal and a former governor of the Canadian Tax Foundation.

#### EDITORIAL

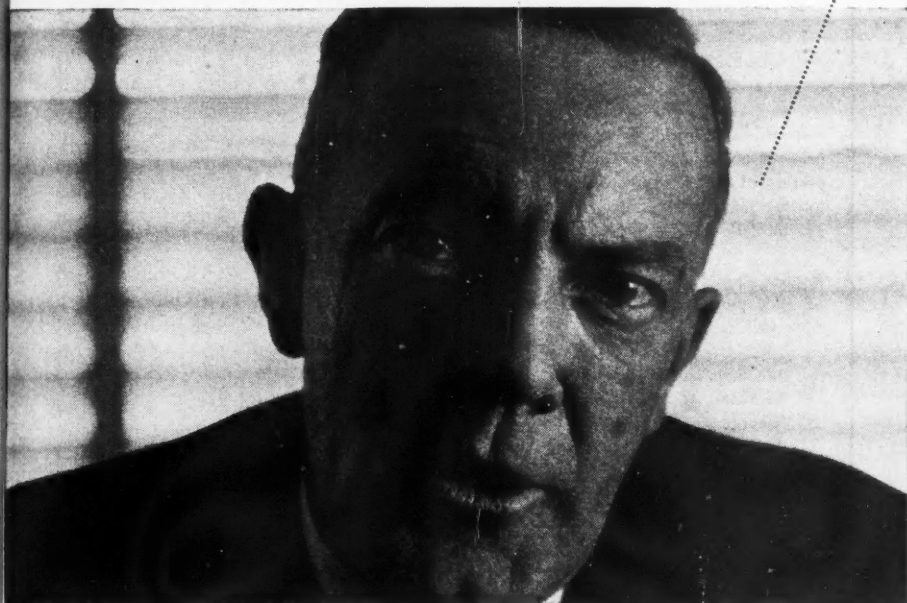
The self-employed members of all professions are equally concerned

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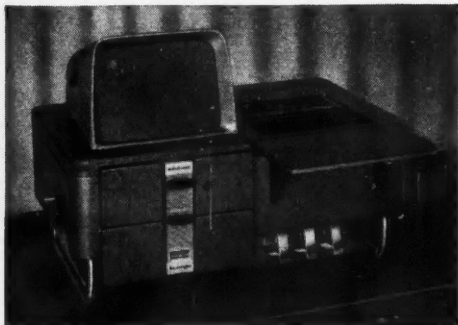




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## PHOTOGRAPHS

Copies of the three keynote addresses presented at the annual conference by V. W. T. Scully, J. C. Thompson and W. G. Mann may be obtained by writing to the Editor, *The Canadian Chartered Accountant*, 69 Bloor Street East, Toronto. Copies of any of the conference photographs at \$1.00 each are also available. When ordering, do not send any remittance. An invoice will be sent when the order is filled.

*Continued from page 286*

with the possibility of remedial legislation which would allow some provision for tax relief in connection with pension premiums. In this month's editorial "Pension Plans for the Self-Employed", Willard Hamilton asks whether it is too much to hope that the income tax revisions for 1957 may include some provisions for the deduction of pension contributions. The editorial reviews the progress that has been made in the United Kingdom and the United States.

Mr. Hamilton is a vice-chairman of the Canadian Tax Foundation and a partner of Price Waterhouse & Company of Montreal. He obtained his certificate in chartered accountancy nearly 25 years ago and is a member of the Institute of Chartered Accountants of Saskatchewan and Quebec.

## FORTHCOMING FEATURES

BUYING AND SELLING A  
BUSINESS  
*Campbell W. Leach*

THE AUDITOR-GENERAL —  
WATCHDOG OF PARLIAMENT  
*Ian Stevenson*

TERMINAL GRAIN ELEVATOR  
ACCOUNTING  
*J. C. Wachal*

TAXATION OF FARM INCOME  
*Alan W. Bell*

REVIEW OF ELECTRONIC EQUIPMENT  
*H. S. Brown*

STATISTICAL THEORY IN  
TEST CHECKING  
*E. L. Pursey*



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## NOTES AND COMMENTS

### Revenue from Succession Duties

The federal tax-gatherer reached into the funds of 5,000 estates during the last fiscal year to take \$75 millions in succession duties, reports CCH Canadian Limited, publishers of books on taxation. This was some \$30 millions in excess of the previous year and considerably above the annual collection. However, two-thirds of the increase can be attributed to the fact that one very large estate (the largest in the history of federal succession duties) became liable for duties during the year.

Of the 5,000 assessments made, only 59 were appealed and of these 52 were settled satisfactorily without recourse to litigation.

### Canadians on Wheels

There is now a motor vehicle for every 3.9 persons in Canada, and a passenger car for every 5.3, according to figures released by the Canadian Automobile Chamber of Commerce in the 1956 edition of "Facts and Figures of the Automobile Industry". Total vehicles registered in Canada amount to almost 4 million. New passenger car sales for 1955 were a record 386,962 units, a 24.6% increase over 1954 sales. The resulting additional revenue has benefited not only those in the automotive industry but also the federal and provincial governments. Provincial governments collected an estimated \$335 millions in registration fees and gasoline tax — 25% of the total provincial revenue.

During 1955, more than 100,000 households entered the car-owning class, while another 21,000 bought an additional car.

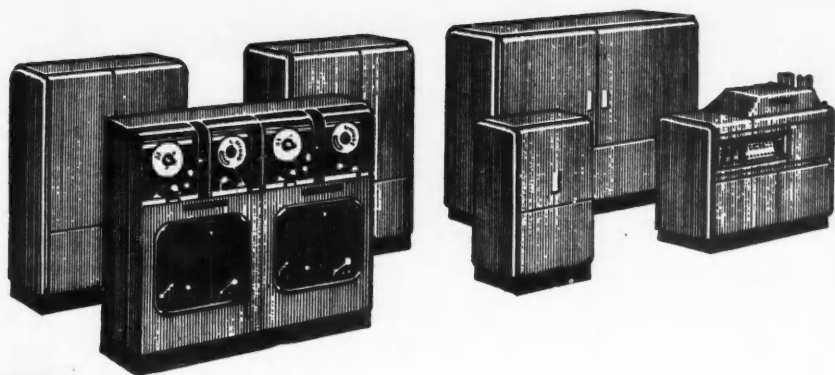
### Money from Here to There

The International Finance Corporation, a child of the International Bank for Reconstruction and Development, has recently been established for the purpose of stimulating the international flow of private risk capital. Analyzing its possibilities, the Bank of Montreal Business Review, August 1956 states that IFC can perform a two-fold function. First, it will consult with responsible officials in an attempt to make conditions in underdeveloped countries favourable to the investment of venture capital and then find suitable investors. Secondly, unlike other agencies which have in the past made loans on guarantee of repayment, IFC can invest its own funds in "productive enterprises in the territories of its members" without requiring security. The corporation commences operations with a capital subscription of \$78 millions, of which Canada has supplied \$3.6 millions.

### Contribution to Research

"Oil Accounting: Principles of Oil Exploration and Production Accounting in Canada" by Robert E. Waller, C.A. has just been published by the University of Toronto Press. Sponsored by the Accounting and Audit-

*Continued on page 292*



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ing Research Committee of the Canadian Institute of Chartered Accountants, this book fills a large gap in the published material concerning the accounts of the oil industry. Copies at \$5.50 each may be obtained direct from the University of Toronto Press, King's College Road, Toronto 5, Ontario.

#### A Reminder

At the end of August every member of the C.I.C.A. received by mail a form asking for the names of potential subscribers to *The Canadian Chartered Accountant*. The returns so far received indicate that a great many members have still to be heard from. We appeal most earnestly for the cooperation of those both in practice and in industry who have not yet returned their forms to do so as soon as possible. The campaign for new subscribers is due to get underway this month and a 4-page brochure, is now being prepared for mailing.

#### Tax Foundation Publication

Latest publication of the Canadian Tax Foundation is the 1956-57 edition of "The National Finances", an analysis of the program of revenues and expenditures of the Government of Canada. For the first time this study includes sections on Crown corporations and the new health insurance proposals as well as an explanation of the new proposals for federal-provincial tax sharing.

#### Out of Sight

A probe of absenteeism in Canadian industry has been conducted on behalf of the Health League of Canada by a committee under the chairmanship of Dr. C. W. MacMillan, professor of Health and Social Medi-

cine at McGill University. The committee has arrived at the following conclusions:

1. Workers under 20 have the highest rate of absenteeism.
2. Workers over 50 and handicapped workers are most apt to stay on the job.
3. Women are absent more frequently than men and married women are away more often than single women.
4. Most absences occur on the last day of the work week, on Mondays and on the day after pay day.

#### McGill's Summer School in Accountancy

The enrolment at McGill's Summer School in Accountancy was double that of last year, with 42 students from across Canada and one from the Bahamas registered. The four-week school was under the direction of Professor K. F. Byrd, director of the School of Commerce at McGill.

#### Internal Auditing Course

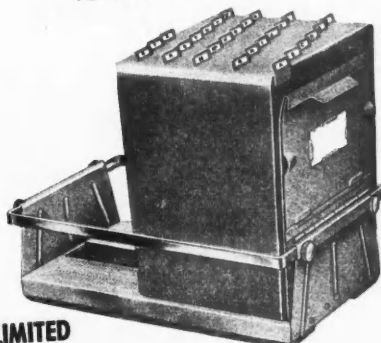
The Institute of Internal Auditors (Toronto Chapter) in cooperation with the University of Toronto Extension Department is presenting two courses in internal auditing in the 1956-57 academic season. The fall course of ten sessions is designed to provide a basic outline of internal auditing and its application to the major features of business and industry. The spring course is for those seeking advanced knowledge of internal auditing on a managerial level. Fee for each course is \$15. Full details and application forms may be obtained from The Director, University Extension, University of Toronto, 65 St. George Street, Toronto 5, Ontario.

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Waller's OIL ACCOUNTING fills an accounting need that has grown as rapidly as the petroleum industry in Canada. The discussions of cost allocation, depletion and depreciation, income measurement, and statement disclosure, will attract the attention of specialist and non-specialist alike.

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# **C.I.C.A.**

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In cooperation with the University of Toronto we are publishing a Directory of Chartered Accountants in Canada which will be available early in November. The directory will compromise approximately 300 pages and will be cloth bound, gold stamped on the face and spine. The price is \$3.00 to members and orders may be placed now. Order forms were mailed with the C.I.C.A. annual report.

### ★ **a new service . . . . .**

In addition to the alphabetical listings by Provinces, two new features have been introduced. Every firm of practising chartered accountants will be listed by towns and Provinces, together with the names of partners or principals. Thus you can see at a glance the firms which are practising in any locality. A third section will be indexed alphabetically for speedy reference. This will obviate the necessity of searching through more than one Provincial listing in order to find a required name.

### ★ **a new coverage . .**

This new Chartered Accountants' Directory, apart from being indispensable to members of the profession, will be a useful reference to chartered banks in Canada and abroad, and to other organizations who work with chartered accountants. It is a worthy publication with far greater impact than former editions.

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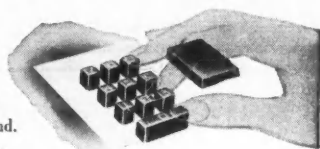
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# Editorial

## PENSION PLANS FOR THE SELF-EMPLOYED

FOR SEVERAL years past, the problem of tax deductions for contributions to pension plans for the self-employed has been receiving the concerted attention of professional people and self-employed persons generally in the United Kingdom, in the United States and in Canada. It is interesting to review the progress in the other two countries and to speculate on the possibility of remedial legislation in Canada in the foreseeable future.

On July 13, 1956 the House of Commons in the United Kingdom gave third reading to the Finance Bill which provided for tax relief to the self-employed in respect of pension premiums. This "measure of fiscal justice", in the words of the Chancellor of the Exchequer, permits the deduction of premiums paid up to 10% of of earnings with a maximum annual deduction of £750. Such premiums must be paid to an insurance company or into a trust fund to obtain a non-assignable, non-commutable life annuity. Needless to say, professional persons and other self-employed people (estimated to total about 2,000,000) were very happy to receive the good news.

In the United States, long and arduous labours on the part of various professional bodies and others succeeded, last year, in placing before Congress the Jenkins-Keogh Bills designed to provide a tax deduction for contributions to retirement plans for the self-employed. Treasury Department officials indicated general sympathy to the equity considerations but stated frankly that, "In view of the revenue loss involved in even a narrowly limited plan, the Treasury Department does not favour the adoption this year of any plan giving tax exclusions for savings for retirement income to self-employed people." The protagonists of the bills were hopeful that some action would be taken during the recent session of Congress but, unfortunately, the matter was deferred for still another year.

In Canada, equally strenuous efforts have been made over the past several years by professional associations and other bodies in an endeavour to secure due recognition by the Government at least to the validity of the claim of the self-employed to treatment comparable to that available to salary and wage earners. Some three years ago the Minister of Finance made a lengthy formal statement setting forth the Government's thinking at that time. It was not readily admitted that discrimination did exist as between salaried employees, who enjoyed the benefit of tax deductions for pension contributions, and the self-employed.

The present Minister of Finance appears to be more sympathetic to the problem, as indicated by recent remarks in the House of Commons. It was stated that, "This is a problem which is becoming more acute . . . both in the United States and in the United Kingdom and is a matter of great study in Canada." The conclusion, however, was that he was not yet in a position to suggest any changes in the law, at least during the current session. (July 31, 1956).

It seems fair to assume, that the equity considerations have now been recognized and that the remaining hurdle is the probable cost to the revenue in extending such concessions to the self-employed. The Minister remarked that a reasonably adequate plan would likely cost the Treasury of Canada ". . . something of the order of \$60,000,000", per annum. Nevertheless, in the same statement he advised the House that the combined contributions of employers and employees to approved pension plans in the last taxation year aggregated \$255,000,000 and commented that, "The government is bound to look upon these plans not only with interest but with encouragement."

The budget surplus for the three months ending June 30, 1956 has been reported as \$220 millions and reliable estimates suggest a possible surplus for the fiscal year ending March 31, 1957 as high as \$400 millions. Is it too much to hope that the income tax revisions for 1957, an election year, will include appropriate provisions for the deduction of pension contributions by the self-employed? Responsibility for amending legislation lies with our elected representatives, but this responsibility is not likely to be met unless the views on this important subject of an estimated 400,000 self-employed persons are duly made known to them.

# The Role of Alberta's Petroleum and Natural Gas Conservation Board

N. A. MACLEOD

ON JUNE 16, 1956, Alberta's oil and gas industry celebrated the 20th anniversary of the discovery of crude oil in the west flank of the Turner Valley Field, Canada's first major oil field. Prior to this, large volumes of gas were wastefully produced from what is now known as the "Turner Valley Gas Cap" in order that a relatively small volume of naphtha and distillate might be recovered, a type of operation that would not be tolerated today. As a direct result of the experience gained from the Turner Valley Field, Alberta's first Oil and Gas Resources Conservation Act was passed in 1938. It proved to be of very practical importance in guiding the great expansion of the Province's oil and gas industry following the Leduc strike in 1947.

The original Act has been amended and replaced over the years, and the Act now in force is known as The Oil and Gas Resources Conservation Act, 1950. Its purpose is:

- (a) To effect the conservation of the oil and gas resources of the Province — i.e. the elimination of avoidable waste and the securing of the maximum efficient recovery of oil and gas from reservoirs in accordance with sound

engineering and economic practices.

- (b) To regulate operations connected with drilling, production and abandonment of wells.
- (c) To give each owner the opportunity of obtaining his just and equitable share of the production from any pool.

The Act applies to all wells in the Province regardless of whether they are on Crown or freehold lands.

## Organization of the Board

Constituted under the Conservation Act, the Petroleum and Natural Gas Conservation Board is charged with the administration of the Act. The Board is a body politic and corporate consisting of three members who are appointed for a term of five years and thereafter during the pleasure of the Lieutenant Governor in Council. Members of the Board are Ian N. McKinnon, chairman, D. P. Goodall, deputy chairman, and Dr. George W. Govier. Dr. Govier is also head of the Department of Chemical and Petroleum Engineering at the University of Alberta. There has been no change in membership during the past eight years. Members are prohibited from holding any interest whatsoever in

any oil or gas property or in any business connected with the oil and gas industry.

The Board's staff, including geologists, engineers and statisticians, numbers over 150 at the present time. In addition the services of technical experts are often used in an advisory capacity.

The head office is located in Calgary with eight regional offices spotted strategically throughout the Province. The Board is financed by Government and industry on an approximately fifty-fifty basis.

### Drilling Operations

An operator must obtain a licence before drilling a well for oil or gas and must deposit \$2500 to guarantee compliance with the Conservation Act and regulations made under it.

The well licensing system enables the Board to keep track of all drilling operations. Its field staff make regular inspections to ensure that these are carried out in a safe and efficient manner in accordance with the regulations and that the necessary drilling reports together with samples of drill cuttings are forwarded to head office.

In the early stages of oil and gas development many unnecessary wells were drilled in an effort to obtain a quick return and also for protection against adverse drainage. Today, however, the Board regulates well spacing through the establishment of spacing or drainage units, as do most similar regulatory bodies in Canada and the United States. The size of a spacing unit depends on the ability of a well to drain an area and the time it would take to do it. The location of a well within a spacing unit must be such that it will enable the owner and operator of the unit to ob-

tain their just and equitable share of the pool production.

### Producing Operations

Also of key importance in ensuring the maximum recovery of oil from a pool is the establishment and maintenance of an optimum rate of production. For this purpose the Board relies heavily on the studies of its Reservoir Department. From time to time this department evaluates the production possibilities of each pool in the light of information obtained in the wells in the pool, its knowledge of the formation in which the pool occurs and of similar pools, and the behaviour during production of the pool.

When an oil discovery is made, the well is given a preliminary "MPR" (or "maximum permissible rate" of production) based largely on the thickness of oil pay encountered. As further drilling enables the pool to be outlined and production history gives the reservoir engineers something to work with, more precise well MPR's are indicated, and finally, with the accumulation of even more data, an MPR may be established for the pool rather than the individual well. These MPR's are calculated by a formula that reflects such diverse factors as acreage, pay thickness, porosity, connate water, shrinkage, nature of reservoir drive, expected recovery, life of the pool, degree of development of the pool, producing gas-oil ratio and producing water-oil ratio. Well and pool MPR's are recalculated every six months.

If the markets available to producers in the Province would take an unlimited amount of oil, then the production rate of wells would be limited only to their MPR's for the prevention

of waste from the engineering point of view. However, markets are not unlimited, and so it is necessary to restrict further the amount each well may produce or to prorate production to market demand. Each month the Board receives nominations from crude oil purchasers on the basis of which it determines the market or the total "provincial allowable" for oil for the following month. Each pool is then assigned a share of the allowable sufficient to enable each well in it to produce its "economic allowance" — an amount varying with the depth of wells and approximately calculated to reflect a reasonable allowance for the major economic factors in the drilling and operating of wells. The balance of the provincial allowable is assigned to the pools in the Province (with attention being paid to the demand for oil of the gravity produced from a pool) in proportion to the MPR's of the pools. The total allocation to a pool is prorated among the wells in the pool, with no well receiving an allocation in excess of its MPR. This method of proration to market demand is intended both to give each operator the opportunity to produce and dispose of his just and equitable share of the oil, and also to prevent economic waste.

The Board has not found it necessary or desirable to establish allowables for all gas wells in the Province. In certain fields, however, reservoir or equity considerations have indicated the need for regulation of gas production. Until recently such regulation was done through the setting of maximum daily rates of withdrawal based upon the "open-flow" or delivery capacity of the individual wells. A new method of setting gas allowables, where the Board considers them necessary, incorporates a volumetric

formula somewhat like that used for computing MPR's for oil wells.

Although the formulation of a secondary recovery scheme basically lies with the producers rather than the Board, one cannot at present discuss conservation practices relating to production without mentioning schemes to augment primary recovery mechanisms in oil pools by the injection of water or gas to the formation. Results that can be achieved from secondary recovery vary widely from pool to pool. In a solution gas drive field that is fairly suitable for secondary recovery, a possible recovery of, say, 15% to 25% of the oil in place might be increased to a recovery of 40% to 50%. In a suitable field where a partial gas or water drive is the primary mechanism, a 35% to 50% recovery of oil may be increased to 50% to 70% of the oil in place. Since even a small increase percentage-wise means a substantial amount of oil, it is important that the Board encourage the introduction of well conceived projects. The Board must approve each scheme before it is proceeded with and continue to review the effect of the operations when the scheme is put into effect to ensure that reservoir damage does not result. If the institution of a scheme requires that there be an agreement of the interested persons for the unit operation of the pool, the Board must also encourage and approve such agreement.

#### Miscellaneous Board Functions

Other regulations applicable to the field are designed to promote good operating practices and may be illustrated by a few examples. Well installations must be equipped to permit ready tests and measurements above

and below ground. Migration of fluids from one underground zone to another by way of a well must be checked. Surface storage of products must be of a kind that minimizes loss. Equipment and installations are regulated with a view to preventing fires and wild wells. Salt water and other fluids produced must not flow over adjacent lands or pollute surface waters. Production must be satisfactorily measured and reported. When operations are concluded the land surface must be restored as nearly as possible to its original condition. Those engaged in drilling must be holders of permits to operate drilling equipment.

The Board provides a repository of information about oil and gas in Alberta that alone could justify that body's operation. Some of the information is treated as confidential for a limited time, particularly when it relates to an area that is in an exploratory or new discovery stage, but the vast bulk of it is open to all. There are cuttings from core samples available to those interested in the geology of a field, statistics on production and oil and gas movements, and test results and records that provide markers in tracing the history and changing conditions in a field.

#### **Gas Conservation**

A look at the Board's policies regarding gas conservation would facilitate the understanding of its gas pipe line problems. The production of gas from dry gas or condensate fields is permitted only where the gas is sold or put to effective use. Where the production of gas with oil at a reasonable gas-oil ratio occurs, a waste of gas may be suffered initially to permit the development of the oil field. Where gas is produced at a high gas-oil ratio the oil allowable is

reduced by application of a penalty factor. When a field has been fairly well outlined, the Board insists as a condition of continued production that a scheme for the conservation of gas be instituted if it believes the operation of such a project will, during the life of the field, pay back the necessary investment and yield a utility rate of return.

#### **The Gas Resources Preservation Act**

Immediately after the Leduc discovery, the booming oil hunt showed rapidly increasing gas reserves in Alberta and no policy under which they would be evaluated, developed and used. The Provincial Government in 1948 appointed a Royal Commission under the chairmanship of R. J. Dinning to study these matters. The Dinning Report of March 1949 stated that there were proven reserves of marketable, dry, clean gas of about 3.5 trillion cubic feet, and excellent speculative prospects of more reserves. The Commission also expressed accord with the principle that the requirements of the people of the Province should have prior claim on the supplies of natural gas within Alberta.

Shortly afterwards, in April 1949, the Pipe Lines Act was passed in Ottawa. When the federal Act was under consideration representations were made to include provisions to safeguard the supply of gas in producing Provinces to meet local requirements. However, the view was expressed by the Prime Minister that the remedy lay within the legislative competence of the Provinces concerned.

The Gas Resources Preservation Act of Alberta passed in June 1949 is in accordance with recommendations

of the Dinning Commission. The new Gas Resources Preservation Act, 1956 is a revision and consolidation of the 1949 Act, presenting no substantial change but bringing into use the benefit of a half dozen years of administrative experience.

The Preservation Act requires that any removal of gas produced in the Province for use and consumption elsewhere shall proceed only if authorized by a permit granted under the Act. The application for a permit is made to the Board. The Board is required to hold a hearing, and may thereupon, with the approval of the Lieutenant Governor in Council, grant subject to such terms and conditions as may be prescribed therein or refuse a permit or defer consideration of an application.

A provision of the Preservation Act that a permit shall not be granted unless the Board is of the opinion that it is in the public interest having regard to the present and future needs of persons within the Province and to the established reserves and trends in growth and discovery of reserves of gas in the Province. Since 1951, the Board has prepared estimates of the established reserves of marketable gas each year. There has been a steady increase. In its latest report, dated November 1, 1955, the established reserves of gas in the Province is given as 15.6 trillion cubic feet, as compared with the 3.5 trillion cubic feet of the Dinning Report.

The 1951 report found that the requirements within the Province would be adequately protected by the provision of sufficient reserves of pipe line gas to maintain supply and delivery for 30 years. This standard was accepted by the Alberta Government and has been used since that

time. The November 1955 report estimates the natural gas requirements in the Province for the 30-year period ending December 31, 1984 to be approximately 6 trillion cubic feet.

#### Permits under the Preservation Act

There is some variance in the terms and conditions to which a permit may be subject to meet what appears to be the particular circumstances in which the regulation may be needed. The typical permit will contain terms setting out the period for which the permit is granted, stating the yearly and total maximum volumes of gas that may be removed, defining the area or naming the fields from which the gas may be taken, requiring that the permittee make gas available to supply communities in the Province adjacent to the pipe line, providing for the extraction of any substance except methane before the gas is removed from the Province, requiring the permittee to show that he has completed arrangements for financing and has commenced construction of his line prior to stated dates, and providing that the permittee shall take delivery of the gas to be removed at a point near that at which it will be removed from the Province.

(In the typical case the delivery of gas is made to a permittee from a pipe line operating in the Province under authority granted by the Minister of Highways pursuant to The Pipe Line Act, 1952 of the Province. The Minister before granting such authority receives a report from the Board on an application respecting a proposed provincial line. Thus the Board is concerned with the gathering pipe lines in the Province, as well as the removal of the gas from the Province.)

#### Permits under the Preservation Act



authorizing substantial removals of gas are held by the following:

*Peace River Transmission Company Limited* is the holder of a permit granted Westcoast Transmission Company Limited and assigned to Peace River. The permit granted in 1955 authorizes the removal during a 30-year term of 13 billion cubic feet of gas for the Town of Dawson Creek from the Pouce Coupe Field.

*Canadian Montana Pipeline Company* holds a permit as the assignee of McColl-Frontenac Oil Company Limited and Union Oil Company of California. In 1951 a 5-year permit was authorized by a special Act as a defence measure to make gas available to the Anaconda Copper plant in Montana. A further 20-year permit was issued under the Preservation Act in 1954 and, subject to local requirements, authorizes removal of the gas in the Pakowki Field.

*Westcoast Transmission Company Limited* and *Westcoast Transmission Company (Alberta) Ltd.* were granted a permit in June 1952 to remove gas produced in a described area in the Peace River region. The first named permittee is the interprovincial company, and the latter is the company that will operate the gathering lines within the Province. The permit has been amended from time to time to adjust it to delays in obtaining the Federal Power Commission approval to the import of gas into the United States, and also to increase the volumes of gas that may be removed in light of the development of additional reserves. The period of the permit now runs from June 1952 to December 31, 1979, and the total volume of gas covered thereby is 1.1 trillion cubic feet. Construction of the Westcoast lines is now sufficiently

advanced to indicate some B.C. communities will be served next winter and the line completed in 1957.

*Trans-Canada Pipe Lines Limited* holds a permit issued to it in May 1954 making gas available for a project to pipe gas to Central and Eastern Canada by an all-Canadian route and to export 200 million cubic feet per day to the United States. This permit also has been amended from time to time as the permittee has met obstacles and delays in obtaining the preliminary requirements to being in a position to proceed with the project. The permit authorizes the removal of 4.35 trillion cubic feet of gas and is for a 27-year period. Under the permit, Trans-Canada has until November 1, 1956 to satisfy the Board that arrangements to finance construction have been made, but this may be extended to April 2, 1957, if construction of the Alberta to Winnipeg section is started by July 31, 1956. The effective commencement of the removal of gas must occur by the end of 1957.

As this is written, Trans-Canada's prospects are somewhat more sanguine than they have been at any earlier date. Its groundwork is sufficiently advanced that even if further delays occur it can have a cross-country pipe line in operation far sooner than could any rival that might seek to supplant it. It has agreements with gas producers for the sale to it of 95% of its gas requirements. With respect to the Alberta to Winnipeg section of the line, funds to meet construction expenses will be advanced by a Crown corporation by reason of a loan agreement approved by Parliament. Some pipe has been delivered, construction is about to commence and operation by the end of the current year is aimed at. While



its hearings before the American Federal Power Commission are continuing, contracts have been obtained for sufficient sales to Canadian customers that the project may be financed without export to the United States. On the darker side, it is likely that the critical pipe supply will be aggravated by labour disputes in the steel industry south of the border.

### **The Future of Interprovincial Gas Transmission**

The proven reserves of gas in Alberta available to outside markets are sufficient to meet present commitments. However, for a healthy gas pipe line industry continued growth of such reserves to offset depletion and to serve expanding markets is essential.

The now proven reserves were discovered in the course of drilling about 3,000 wildcat wells. As the sedimentary areas in Alberta cover 200,000 square miles, this averages about one wildcat well for each 65 square miles. It also results in an average overall discovery rate of 6 billion cubic feet of gas per wildcat well. Using these figures and the conservative assumption that the next 25 years may see the drilling of 12,500 wildcats and that the overall discovery rate may drop as much as 40% as the location of wells becomes denser, the discovery of another 45 trillion cubic feet

of gas with consequent remaining marketable reserves of 35 trillion cubic feet in 1980 is forecast.

In the meantime, the exporters are likely to find that they can handle greater volumes of gas when their lines are operating successfully. Also, it is expected that other pipe line companies will be seeking Alberta gas as proved reserves increase. Alberta's position as a source to which others will look for gas may be appreciated by a comparison of life-index figures. The life-index is the ratio of year-end marketable reserves to the year's marketed production. The Alberta life-index at the end of 1954 was 153. The corresponding life-index figure of the U.S.A. was about 24, but is thought to be declining. For 1980 the forecast Alberta figure is 25, based on a 20-fold increase in marketed production.

Much of the now proven gas reserves was discovered and evaluated incidentally to the search for and development of oil reserves, and a considerable increase in gas reserves may be realized in the same way. However, there are easily foreseeable demands of gas that are likely to be filled only if exploration and development of gas reserves for the gas itself is pursued. The incentive for this is a satisfactory market, which can be provided by the extra-provincial pipe lines and the maintenance of a reasonable price to the producer.

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## THE CANADIAN CHARTERED ACCOUNTANT AWARDS 1955 - 1956

### Article Writing Competition

<i>First Prize, \$300</i>	—	D. R. GILMASTER, Fleet Manufacturing Co. Ltd., Fort Erie, Ont., for his article entitled "Cents — Less Accounting Makes Sense".
<i>Second Prize, \$200</i>	—	ALAN W. BELL, Williams, Tanner & Bell, Lethbridge, Alta., for his article entitled "Taxation of Farm Income".
<i>Third Prize, \$100</i>	—	E. W. NETTEN, 483 Crescent Street, St. Lambert, Que., for his article entitled "Accountancy of the Future".
<i>Honourable Mention</i>	—	W. M. KARNEY, Mannix Ltd., Calgary, Alta., for his article entitled "Accounting in the Heavy Construction Industry".

*The Canadian Chartered Accountant* is pleased to publish the above results of the 1955-56 Article Writing Competition. In July of last year the first announcement appeared, giving particulars of the Competition, designed to encourage students and more recent members to submit material to their professional journal. The Competition closed on February 29, 1956.

Contestants were permitted to write on any subject of their choice relevant to the field of accounting, auditing or taxation. According to the rules, the names of those entering the Competition were to remain unknown to the Magazine Committee and the judges until after their decision had been reported.

The winning entry appears in this issue of *The Canadian Chartered Accountant*. The second and third prize winning entries will appear in subsequent issues.

# Cents-Less Accounting Makes Sense

DOUGLAS R. GILMASTER

IT HAS BEEN SAID that "Accounting is an exact science based on wild assumptions". When one considers the extent to which operating results are dependent on estimates and the opinions of individuals, this statement does not seem quite as far-fetched as it appears at first glance. With this in mind, it seems rather incongruous that there is frequently such rigid insistence in recording pennies in costs, giving them the superficial appearance of extreme accuracy.

There has been a noticeable trend in the elimination of pennies from financial statements and reports and it is hardly necessary to comment on the improved appearance and readability. However, to convert these statements from dollars and cents to whole dollars is often a tedious and time-consuming task when all book balances are kept in exact amounts. It was for this reason that our company began to explore the possibilities of eliminating pennies at the source and maintaining most of our accounts in whole dollars. While this is not a new concept, our method is rather unique in its operation.

## Advantages of the System

After studying the possibility of utilizing this system, we discovered

that the initial reason for considering this change was far down the list of advantages to be gained. Briefly the major advantages are as follows:

1. Errors occur most frequently in pennies, whether it be in posting, trial balances, tabulating, typing or checking. By eliminating pennies in the majority of accounts, the figures are easier to remember and errors are located with much less effort.
2. A multi-column schedule often becomes bunched and crowded. By eliminating the decimal and the pennies, three spaces are saved in each figure. Through this elimination, 2,250 typing strokes alone are saved in a 15-column, 50-line schedule.
3. The average figure consists of 3 dollar digits and 2 penny digits. By eliminating pennies, all work dealing with the figures is reduced by 40%. When this is applied to jobs requiring considerable calculation, such as distribution of expenses, extension of inventories, statistical work, etc., the potential savings become even more significant. As most figures are used several times in the process of statement preparation, time savings are accumulative.

As an illustration, consider extending an inventory having 10,000 items. The cents can be dropped from the total for each item, reducing the number of figures that must be transcribed by 20,000. The figures must then be added, at which time another 20,000 figures are eliminated. If the inventory sheets are typed 30,000 typing strokes are saved, considering the decimal as well as the pennies. Using the five digit average previously mentioned, 160,000 digits would be processed in the complete extending, listing and typing if cents are preserved. By using even dollars, this total is reduced to 90,000. On an inventory of this size, the difference between recording exact amounts as opposed to even dollars will not be significant.

### Making the Decision

It would be most unwise to make a decision in favour of adopting this system without first making a detailed study of its practicability as applied to a particular system. Careful consideration must be given to the following points:

1. At what point will cents be eliminated?
2. Which accounts will have cents eliminated?
3. How will they be eliminated?
4. What control can be installed that eliminations are handled correctly?
5. Who will handle the eliminations?

The decision on the first point will mean the difference between success and failure of the system. To gain the maximum benefit, cents must be eliminated at the earliest possible stage in the recording of the transactions.

As to the second point, all accounts

dealing with external transactions must be carried in exact amounts. These include cash, accounts receivable, accounts payable and payroll. All other accounts — income, expense, and cost accounts, fixed assets, inventories, prepaid expenses and accruals — can be maintained in even dollars. It is most important to have all accounts in even dollars in the profit and loss and cost of manufacturing, otherwise much of the value of the system is lost.

### Installation of the System

The next three points are best considered with the overall installation.

The best rule to follow in the dropping of cents, and the rule that provides the maximum degree of offset, is to carry amounts in excess of 50c to the higher dollar, amounts less than 50c to the lower dollar and amounts ending in 50c to the nearest *even* dollar. Thus, \$3.50 becomes \$4 and \$4.50 becomes \$4.

The method to be adopted in the actual dropping of pennies will depend on the bookkeeping system being used. Some systems lend themselves quite readily to a quick and painless conversion; others require more study. In some systems it is not practical at all, particularly in a small business.

In order to eliminate pennies at the pre-posting stage of the bookkeeping cycle, we first considered using a rubber stamp on each invoice showing the even dollars to be posted and the pennies eliminated on each accounting distribution. Journal entries were to be made up in even dollars and were to include a posting for all pennies eliminated. We soon realized there was too much room for error and the whole procedure would be cumbersome. We then tried adapting

the bookkeeping machine used for general ledger and accounts payable to handle the eliminations automatically. It can best be explained how this was accomplished by outlining the posting procedure on this machine before and after installing cents elimination.

Figure I illustrates the machine set-up that was used in posting invoices when all cents were preserved. To explain briefly, a backing sheet (or audit copy) is placed in the machine with a sheet of carbon over it (which, of course, cannot be shown). When an invoice is to be posted, the ledger card is placed in the machine over this audit sheet. The headings and the columns are identical on the audit sheet and the ledger card.

We make use of a three-part voucher, the first copy of which is used as a combination statement and cheque and the remaining copies for filing. The supplier's name is written across the stub of the set as no other identification appears until the cheque is written.

This voucher is then inserted in the machine and lined up with the ledger card. It will be noticed once again that the headings and columns are identical on the audit sheet and the voucher.

In the illustration, invoice No. 704 from A.B.C. Company Ltd. is to be posted. (The balance \$125.63 on this voucher is from a previous posting.) The ledger card and voucher are inserted in the machine as outlined above. Ignoring details such as quantities, date, proof, etc., the procedure is then as follows:

1. Pick up last balance on voucher (\$125.63).
2. Pick up last balance on ledger card (\$678.40).

3. Invoice amount (\$319.78) is posted to the debit column in the ledger account and retained in the machine.
4. Cash discount (\$3.20) is posted to the credit column in the ledger account and retained in the machine.
5. The new ledger balance (\$994.98) is cleared automatically. The gross invoice amount is retained in the machine but the discount amount is cleared.
6. The invoice amount (\$319.78) previously retained in the machine is now cleared automatically in the amount column of the voucher.
7. Cash discount (\$3.20) is posted in the "Deductions & Allowances" column of the voucher.
8. The new voucher balance (\$442.21) is cleared automatically.

The changes we made to this procedure are illustrated in Figure II.

It will be noted that the pennies are automatically eliminated through the changes made in machine set-up. The procedure is now as follows:

1. Pick up last balance on voucher (\$125.63).

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*This article by Douglas R. Gilmaster has been awarded, by unanimous choice of the three judges, first prize in the 1955-56 Article Writing Competition sponsored by THE CANADIAN CHARTERED ACCOUNTANT. The author received his certificate in chartered accountancy in 1951. Formerly chief accountant with Canadian Cellucotton Products Limited, Mr. Gilmaster is now comptroller with Fleet Manufacturing Company Limited, of Fort Erie, Ontario.*

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2. Pick up last balance (\$678.00) on ledger card. (The machine automatically prints ciphers).
3. The net invoice amount (\$316.58) is posted to the "Original Posting" column on the ledger card.
4. The rounded amount (\$317.00) is posted to the "Final Posting" column.
5. The rounded amount together with the last ledger balance is automatically cleared in the "Balance" column of the ledger card. (\$995.00).
6. The net invoice amount is automatically cleared in the "Amount" column of the voucher.
7. Cash discount (\$3.20) is posted in the "Memo Deductions" columns.
8. The new voucher balance of \$442.21 is cleared automatically.

The machine retains the amounts posted in the "Original Posting" and "Final Posting" columns. At the end of each posting run, these counters are cleared and automatically record the amount to be posted to the cents elimination account, being the difference between the totals of the two columns. The backing sheet is scanned to ensure that no errors have occurred in the elimination of pennies.

Note that the separate columns for Dr. & Cr. have been combined in one, with credits having a symbol (◆) beside them, and posted in red. Because of this, it was necessary to post net amounts (after deducting cash discounts) and, to keep the supplier informed, to show these deductions as a memo on the voucher.

As all income and expense accounts are in even dollars, many of our journal entries, particularly those dealing with internal expense distributions, can be made up with the pen-

nies eliminated. For entries in which pennies do appear, the machine posting is the same except, of course, there is no posting to the voucher.

By making use of the machine as a means of eliminating pennies, no additional work is involved. We have a control on the actual eliminations, thus avoiding the main pitfall of the system, and have centralized responsibility.

It was mentioned previously that the total pennies eliminated from each posting run are posted to an account called "Cents Elimination". We carry this as a deferred charge to avoid having any accounts with pennies in the profit and loss or cost of manufacturing sections. The balance of this account is cleared to the nearest dollar to a profit and loss account at the year-end.

To simplify taking off the monthly balance sheet in even dollars, we make a "temporary cents elimination" run on all accounts which have pennies preserved. The machine operator performs this elimination by clearing all pennies that appear in the accounts and *not* by taking the balance to the nearest dollar. Thus, \$4.85 becomes \$4.00 and \$4.19 becomes \$4.00. When the net balance of this run is posted to the cents elimination account, all pennies in this account are cleared automatically. If they do not clear, then an error has been made. This run is reversed at the beginning of the following month. No journal entries are required.

As an additional reminder to the operator, all accounts having pennies preserved are flagged. Out of a total of over 1,200 general ledger accounts, we preserve pennies in only 65 accounts.

To avoid losing some measure of

DISTRIBUTION AND VOUCHER REGISTER									
QUANTITY TO DAY	SUPPLIER	QUANTITY TO DATE	DATE	FOLIO	ACCOUNT NUMBER	DEBITS	CREDITS	PROOF	BALANCE
GENERAL LEDGER NAME <u>COST OF MANUFACTURING-DEPT A</u> ACCOUNT No. 801-0502									
DISTRIBUTION LEDGER NAME <u>MAINTENANCE MATERIALS</u>									
QUANTITY TO DAY	SUPPLIER	QUANTITY TO DATE	DATE	FOLIO	ACCOUNT NUMBER	DEBITS	CREDITS	PROOF	BALANCE
	A. SMITH- 9451		Nov 2/55	33724	801,502	678.40		.00T	678.40
	A.B.C. Co. Ltd - 704		Nov 18/55	40791	801,502	319.78	3.20	.00T	994.98
VOUCHER No 40791									
A.B.C. Co. Ltd.									
			DATE	FOLIO	AMOUNT	REDUCTIONS AND ALIQUOTES	PROOF	BALANCE	
			Nov 15/55	695	125.43		.00T	125.43	
			Nov 18/55	704	319.78	3.20	.00T	442.21	
(CHEQUE PORTION)									
FIGURE I									







control and possibly complicating existing routines, we did not request other departments to make any changes except where it was obvious that the change could be made easily. For example, the payroll department makes up journal entries in exact amounts for each payroll, but on labour distribution entries it uses whole dollars.

### Ancillary Benefits

Changes in the system necessitated by the change-over proved, in many cases, to be additional benefits in disguise.

For example, postings to an account in which the majority of charges are under 50c would cause no change in the account balance. To overcome this, we recap these charges and make one posting each week, which has saved considerable time.

Another illustration is the recording of bank charges. To simplify this, we had the bank open an "Exchange Account" to which all such charges are posted. We then reimburse the bank once each month and have only one posting to make per month.

As mentioned previously, we now post invoices net of cash discount which saves a posting in the ledger and keeps the account clearer.

Plant ledger records and the related depreciation reserves are all maintained in whole dollars, which simplifies calculation.

### Results

The more significant results that can be measured fairly readily are:

1. The time taken to run and balance the trial balance was reduced

from an average of about 8 hours to 3 hours. This is mainly the result of faster listing with pennies eliminated in about 1,100 accounts as well as errors being less frequent and easier to locate. For example, if the trial balance is out of balance by an amount which includes pennies, the search is immediately narrowed down to about 65 accounts.

2. An average of 27 hours overtime was required to meet statement schedules. This was reduced to about 3 hours.
3. Our schedule formerly called for completion of statements by the 8th of each month, with typing to be completed on the 10th. We now have the statements completed and typed by the 8th.
4. The balance in the cents elimination account at the end of the first year was \$177.73, and at the end of the second year the balance was \$268.78. In both cases it would have been much less had we not been offering a special advertising deal in which most payments ended in 50c.
5. The Income Tax Department appears to have no objection to the system.

Perhaps this whole subject is best summarized by the following:

*Said the Big Tycoon to Mr. Boon,  
"Now, what is this revelation?  
Save twenty percent  
Of the time that is spent  
In statement preparation?"*

*Said Mr. Boon to the Big Tycoon,  
"This is really no pretence.  
If you listen to me  
I'm sure you'll agree,  
There is nothing as senseless as cents."*

# Impact of Taxation on Corporate Management

F. S. CAPON

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THE CORPORATION tax has assumed such an important place in total governmental revenue services that it has a direct and sometimes determining impact on most of the broad policies of business and on the vast majority of the detailed transactions that take place every day.

## **Fifty Cents on the Dollar to the Silent Partner**

The impact of taxation on day-to-day policies can best be realized if we look upon the tax collector as a silent partner taking about one-half of the taxable income without sharing in any way the responsibilities of running the business. Obviously, corporate policies must be geared to ensure that the maximum percentage of incoming dollars can properly be regarded as "non-taxable income" in the company's ledgers or "capital receipts", while the maximum amount of outgoing or expense dollars can be designated "taxable income". They must be tailored so that the greatest possible proportion of income is non-taxable and the greatest possible proportion of expense is allowable. Constant awareness that on the taxable income or allowable expense side we

are dealing with 50 cent dollars while on the non-taxable income or disallowed expense side we have 100 cent dollars will bring home the importance of this distinction.

## **Basic Principles**

There are some general principles which may be rated as of outstanding importance in taxation aspects of day-to-day business policy and decision-making.

First is the importance of clear and accurate records. The number of business transactions of a borderline nature taxwise is amazing and in probably nine cases out of ten the side of the fence on which an item will be placed by assessors will be decided by the manner in which it is recorded. If an expense item is recorded in such a way that it seems disallowable, the assessor cannot be blamed for adding it back. The Income Tax Appeal Board will probably have little sympathy with the taxpayer who tries to convince them that the disallowed item really was not what the taxpayer's own records showed it to be. Once the record is completed, it is too late to change it;

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it is best to make sure it is right in the first place.

The second principle, which is inextricably bound up with the first, is that one individual should be charged with responsibility on tax matters and he must be fully informed as to what is going on in the company. He cannot keep the tax records straight if he is not thoroughly familiar with the background behind every unusual transaction, whether it is of a revenue, expense or capital nature. He may be head of a tax section, controller, treasurer, vice-president or even president, and as such he must get all the information necessary to ensure that the company's tax bill is kept to the minimum.

Next is the principle of establishing sound relationships with the federal and provincial taxation department. In Canada our tax officials are honest, straightforward people doing a conscientious job of administering complex legislation. They are just, fair-minded and most cooperative in discussing the taxpayer's problems. That they are trying to maximize revenue is axiomatic — so would the taxpayer, if the positions were reversed. To keep abreast of the constantly changing regulations and interpretations of tax laws a good direct relationship with the tax departments is a "must".

The fourth principle — no less important than the other three — is one of rigid honesty regarding taxation. The tax man in a company is primarily responsible for keeping the tax bill down by every proper means at his disposal, particularly by arranging the affairs of the company in such a way as to take advantage of every legitimate loophole. But he is also a policeman for the government, and must prevent businessmen from

trying to pull "fast ones", slipping items through the accounts under false names, because he knows that the small savings made are more than offset by the acquisition of a bad reputation opposite the tax departments of government, to say nothing of adverse publicity on major items.

### Special Tax Effects

Passing on to some of the specific impacts of taxation on corporate policies, there is no need to discuss normal every-day revenue and expense transactions which automatically fall into predetermined places on the income tax form. However, some of the less usual implications of taxation or less frequent types of transaction might be interesting for illustrative purposes.

The income tax law is full of special provisions inserted to achieve a limited economic purpose or as a result of pressure from a particular group. Generally referred to as "incentive taxation" provisions, they include special allowances made to new oil prospects, gold mines, etc., allowances in respect of research expenditures, special depreciation rates allowed during emergency periods, and many others. These provisions often offer very worthwhile benefits to companies generally, and every advantage should be taken of them when they become available.

### "Income" Items

On the income side of the ledger, stress should be placed on the importance of receiving money as capital rather than as income. For example, if patent rights are to be disposed of, they can be sold for a lump sum or leased on a royalty basis. The lump sum is usually non-taxable whereas

the royalty is almost certainly taxable. Therefore, a lower price can often be justified on a lump sum basis than on a royalty basis.

Another income item that has caused concern in recent years is the deposits received on returnable containers or money received for tickets not redeemed. For the most part these are now recognized as taxable, with a reasonable reserve being allowed. However, some large containers are of a capital nature, and if records are kept to show clearly that ownership of the container does not in fact pass to the customer, deposits can still be classified as liabilities rather than as taxable income.

Again on the income side, export sales present special problems because methods used in selling abroad may possibly oblige a company to comply with foreign tax laws. Hence the implications of foreign taxation must be borne in mind at all times by those companies engaged in export business.

#### **"Expense" Items**

Under expense categories, there is a much longer list of items which must be watched from the tax viewpoint and therefore have a direct bearing on the formulation of corporate policies.

First and foremost is that phenomenon of the high tax era, "the philosophy of extravagance". How often do we hear the comment "Oh, go ahead and spend the money — the government pays for half of it!" This philosophy, started in the excess profits tax days, has led many companies into expense habits which could never be supported on an economic basis. Once acquired, it is virtually impossible to eradicate and can well cause permanent damage to a corporation.

If it is recognized that extravagance and inefficiency are virtually synonymous, the importance of fighting to maintain the true economic evaluation of expenditures at all times will be appreciated.

The next problem may be termed the "third class of expense". Some expenses are deductible for tax purposes in the year in which they are incurred, and others, being of a capital nature, are allowed at fixed rates over a number of years by way of depreciation, depletion or amortization. The third class of expense comprises those items which are, in fact, never deductible for tax purposes. Examples are the cost of organizing a new company, the initial fee for listing shares on a stock exchange and the discount on the sale of an issue of bonds or debentures. These particular items cannot be avoided, but there are many other avoidable outlays which may be disallowed as expenses not necessarily incurred for purposes of earning the income of the year, and yet never be allowed subsequently because they are obviously not laid out for the purpose of earning the income of some particular future year. Since costs which are never allowed are twice as expensive as those which are allowed, there is a real incentive to avoid this third class of expense.

Depreciation is one kind of expense which has a direct and important bearing on corporate policies. The level of tax rates in recent years causes the claiming of depreciation for tax purposes to be a key factor in a company's financing policies. Furthermore, depreciation has been used so extensively for the purpose of special incentive taxation that tax rules on depreciation often tend to override those generally accepted ac-

counting provisions which govern the computation of income. A company must consider its accounting policies opposite tax rules from the viewpoint of reasonableness of depreciation rates, recapture of depreciation in event of sale of assets, depletion allowances and special capital cost allowances. It must weigh carefully the advantages of tax rules versus the often conflicting conservative accounting rules. When depreciation rates allowable for tax purposes are sharply higher in early years than are the rates that would be proper from the accounting aspect, capital outlays can be recovered more quickly if depreciation is claimed at the maximum allowable rate. Such a policy has an important bearing on methods used to finance capital outlays, and also poses special accounting problems when it comes to preparing statements showing the true income for the period. Management must therefore be fully advised on the financial effects of adhering to policies regardless of tax rules, or conversely of revising policies to take advantage of changes in tax rules.

Another important area where tax legislation and regulations have a determining influence is inventory valuation. Businessmen know that in certain industries the last-in, first-out (*Lifo*) method of inventory valuation results in the most accurate determination of income for a given period, but the refusal of governments to recognize this basis for tax purposes usually makes its adoption in the accounts impractical. Thus accounting and financial policies must be distorted, because the effect on income after taxes would be too great if inventory valuation policies should result in substantial disallowances of costs as charges against taxable in-

come. The tax law may ultimately be changed, but in the meantime it will continue to affect inventory valuation policies.

### Consistency of Accounting Policy

Modern tax assessing has gone far towards preventing the switching of accounting policies from year to year. At one time business could make changes in policies with relative impunity, and these changes could have quite an effect on profits or taxable income in any one year. The general rule now is that any changes in accounting policy must come under close scrutiny and be very thoroughly justified. Here again accurate documentation is essential.

Recognition by tax authorities of the principle of carry-back and carry-forward of losses has gone a long way towards preventing deliberate distortion of policies. In the past, costs and expenses would be deferred by fair means or foul if operations were being carried on at a loss, in the hope that they could be deducted from taxable income in some future period. Since a loss can now be offset against either past or future profit for a relatively long period, there is less incentive to depart from sound accounting policies.

### Tax Impact on New Capitalization

It is important to refer briefly to the tax impact on capital transactions. Taxation aspects are so important that they may often govern decisions concerning the type of new capital required and the means to be used in raising capital by any company.

The fact that bond or debenture interest is deductible from taxable income, whereas dividends on preferred or common stocks or interest on income debentures is not allowable,

has been directly responsible for the very heavy proportion of capital raised by the debt route in the past 30 years. Recognizing the economic and administrative disadvantages of debt financing, except in those cases where the added security is essential for the raising of money, it is appalling to realize the extent to which tax laws have influenced business decisions in the wrong direction.

The recent decision to allow a tax credit of 20% on Canadian dividends may serve as a partial offset against the tax advantage of bonds. Nevertheless, tax laws have caused us to develop a rigid form of corporate financial structure based on a heavy proportion of debt capital which cannot help but be increasingly harmful under adverse business conditions.

It is to be hoped that businessmen will have the fortitude to base future decisions regarding the raising of capital more on sound economic or administrative grounds than on tax considerations.

There are many steps that can be taken to keep to a minimum the proportion of total revenue subject to tax and also to keep to a minimum the total of costs and expenses disallowed as a charge against taxable income. Throughout business, the importance of having a sound knowledge of tax laws and regulations, of keeping thoroughly informed the individual charged with responsibility in tax matters, and finally of maintaining clear and accurate records of all transactions cannot be overstated. However, it is not sufficient that knowledge of tax matters be concentrated in one individual in a company. Taxation has a direct impact on virtually every policy bearing on day-to-day corporate administration, and every branch of corporate management should have sufficient knowledge of the specific impact of taxation to permit the planning and implementation of those policies designed to minimize taxation and maximize net income.

### THE PROTEST WAS IN VAIN

It was inevitable that the development of income tax legislation should lead to a degree of intrusion into the personal affairs of the citizen that would have been unthinkable a few years ago. In a research lecture given in 1952, Mr. J. M. Greenwood quoted the views of a certain John Knyveton who, when Pitt's new tax was introduced at the turn of the 18th century, wrote this in his diary:

"It is now actually proposed to place a TAX ON INCOMES! . . . It is a vile, jacobin, jumped-up-jack-in-office piece of impertinence — is a true Briton to have no privacy? Are the fruits of his labour and toil to be picked over, farthing by farthing, by the pimply minions of bureaucracy?"

—From "Income Tax and the Wandering Minstrel" in  
*The Australian Accountant*, June 1956.

# Estate Planning

A. J. LITTLE

THE WORDS "estate planning" will doubtless have a variety of meanings for a variety of people and may even include landscape gardening. The number of appropriate definitions probably depends only upon the number of experts who attempt a definition, but the more usual would likely embody one or more of the following ideas or principles:

- planning the creation of an adequate estate during one's lifetime.
- planning the management and direction of an existing estate.
- planning the disposition of an estate in order to best carry out one's wishes in providing for the security, well being and happiness of those left behind (and perhaps in order to create a monument for oneself).
- planning an estate in a way that will provide funds for the payment of succession duties and the same time avoid any unnecessary duties.

The accountant, who naturally thinks largely in terms of the tax problems involved in estates, probably places greatest emphasis on the last point. In his opinion his important function is to advise his clients as to

the ways and means of minimizing death duties, so long as these do not interfere unduly with the testator's plans for providing for his various beneficiaries.

At the outset one must mention the role played by other experts. Virtually every kind of estate planning involves some consideration of the will, and major changes are usually accomplished by redrafting an existing will. This is a job for a lawyer. While it is neither immoral nor illegal for a person to draw his own will, or to have it drawn by some other non-legal expert, it is certainly foolish in the extreme not to take advantage of the services of the one expert who possesses the necessary competence. Because of their part in the drafting of wills, some lawyers now specialize in the whole field of estate planning. Similarly the place of the competent insurance underwriter must be recognized. Very often it is the insurance expert who brings a plan along to the point where lawyers, accountants and trust companies are called in. The trust companies, unlike the lawyers and accountants, are able to advertise and have also been doing an excellent job of making people estate-conscious. Sometimes



they take the initiative in the handling of an estate. Good planning involves team work by all these experts.

### **The Role of the Accountant**

Estate planning can be a lucrative field for the accountant, but he has largely overlooked it. Perhaps in auditing he is a "watch dog, not a bloodhound", but when it comes to estate planning he might better assume more of the characteristics of a bird dog and fewer of a simple watch dog. Writing in the June 1956 issue of *Journal of Taxation*, (a U.S. publication), Rene A. Wormser said:

"Although estate planning is basically a lawyer's job, he needs the collaboration or assistance of contributive specialists. Of these collateral experts, the one least used in practice is the accountant — a circumstance which is often most regrettable for both attorney and client, and deprives accountants of employment for which they are uniquely fitted. The explanation may be that accountants generally have not familiarized themselves with estate planning or have not made themselves conspicuously available to give technical aid in this field."

While there is doubtless some room for disagreement between the experts as to which one is basically responsible for estate planning, it is hard to challenge the validity of Mr. Wormser's comments about the accountants. His remarks were directed to accountants in the United States, but almost certainly apply with equal force to those in Canada.

Actually the public accountant is in an unique position to develop estate planning work and to render it an exceptional service. Because of his

audit, financial and taxation work he can see estate problems arising. Usually planning is most urgently required where there are complex financial problems involving substantial amounts of money. Although the accountant may be ostensibly engaged for other reasons, it should be easy for him to direct the client's attention to the estate question. Very often the client will be well beyond the normal age for taking out insurance, and therefore it is not logical to expect an insurance underwriter to initiate the proceedings. Because people generally believe that they are immortal, at least until the last moment, they are often negligent about calling in their lawyers to keep wills up to date. Certainly the accountant stands in at least as favourable a position as the others, and perhaps he could develop a better practice in estate planning by simply being a better watch dog, let alone bothering to be a bird dog.

A few thoughts about estate planning techniques may serve to illustrate what can be accomplished. (For convenience any duty computations made herein are applied only to a resident of Ontario.)

### **An Unlimited Field**

Practically everyone with an estate of more than \$50,000 is a potential subscriber of estate planning in some form, because all estates which exceed this sum are subject to death duties. Let us assume that a husband wishes his wife to have a monthly income for life of \$400 in order to live in some degree of comfort and educate the children properly. This would surely be considered a modest sort of program, yet it would require \$120,000 to be invested at 4% to produce this amount of income, or about



\$108,000 to buy the widow at age 40 a life income of \$400 per month from an insurance company. On an estate of \$120,000 passing outright to a widow with two small children, the Ontario and Dominion duties would amount to about \$18,600. This is a relatively serious obligation. Both the Ontario and Federal Acts exempt estates up to \$50,000, but estates over \$50,000 are fully taxable. While the Federal Act allows a deduction of \$20,000 from amounts passing to a widow, increased by \$5,000 for each child who does not benefit under the will, Ontario makes no allowance at all. Having regard to the value of the dollar today, the succession duty deductions and exemptions seem completely out of line, and it is to be hoped that both taxing bodies might correct this situation. However, the purpose of mentioning it here is simply to illustrate that substantial duties can be involved on relatively modest estates, and hence it may be assumed that virtually everyone has an estate problem.

Many people have problems which they do not know exist. For instance, the young man in the example given above may be attempting to provide an income for his wife by adding the maximum "family income" benefits to existing insurance policies. He may have a fairly small face amount of insurance, but for succession duty purposes the value of the income benefit may be substantial. A \$20,000 insurance policy which carried \$400 per month family income benefits could have a value for succession duty purposes as high as \$84,000. This would involve duties of almost \$10,000 and yet there might be no liquid funds at all since the \$20,000 face amount would be payable after the family income benefit period was

completed. The widow would face a serious problem caused by lack of funds immediately available to pay duties, although at first glance she appeared to be reasonably well provided for. The problem of "liquidity" (i.e. ability to pay duties and still carry out the estate plans) faces many estates. At the other end of the scale is the very wealthy person whose estate is tied up in assets which cannot be readily liquidated, such as shares of a privately owned company.

### Useful Devices

If it is agreed that the field of estate planning work is virtually unlimited for the accountant, the next logical step might be to mention a few helpful pointers, although in an article of this sort one naturally cannot give a comprehensive outline of the tactics open to a client.

### LIFE INTERESTS

In many cases, unnecessary duties are paid by one family group because the capital of an estate is passed entirely to a widow who later on, having lived on the income from the estate, passes the remaining capital on to her children or grandchildren. This double succession means that duties are levied twice as the estate passes from one generation to another. The problem is only partially met by certain provisions in the Dominion Succession Duties Act which reduce in part the duties resulting from a "quick succession" (i.e. when one spouse dies within five years of the other). In many cases substantial additional duties might have been avoided if the widow had been left a life interest in the estate with the remainder passing to children or grandchildren.

For example, consider the case of a man with a wife and two adult chil-

dren who leaves an estate of a million dollars after his death. If that estate is willed outright to his widow, duties would amount to \$396,630 and she would be left with a net amount of \$603,370. Probably she would be able to live quite comfortably on the income produced by this sum and to retain the capital to pass to her children. Then suppose that six or more years later she dies and the estate of \$603,370 is left in equal shares to the two adult children. The combined Dominion and Ontario duties on this estate would be \$189,458 so that the children would receive a total of \$413,912, or \$206,956 each.

On the other hand, if the husband had left a life interest in the estate to his wife (age 60) and the remainder interest to his two adult children, the combined Dominion and Ontario duties would have amounted to only \$323,442. The widow would have had a capital sum of \$676,558 (\$73,188 higher than in the foregoing example) and therefore a slightly larger income during her lifetime. Upon her death six or seven years later, the remainder interest, held intact at \$676,558, would have passed to the two children equally without further duties. Thus each would have received \$338,279 or \$131,323 more than otherwise.

Where circumstances permit, the "life interest" method of disposing of an estate is useful for saving substantial amounts of duty. The savings naturally are more pronounced as the estate increases in size and if the widow is older rather than younger, and so on.

#### GIFTS DURING LIFETIME

Often overlooked are the very considerable savings that can be achieved through making gifts to one's ultimate beneficiaries during one's lifetime ra-

ther than by will. There may be a natural reluctance for a person to give away parts of his estate during his lifetime because of the uncertainties of the future, or a desire to be sure of independence and comfort during old age, or a material change in the needs of the beneficiaries over the years. Granted that care must be taken and that circumstances must be right, nonetheless in many cases substantial savings may be won. Gifts made more than three years prior to death escape Dominion duty and those made more than five years prior to death escape both Dominion and Ontario duty. Assuming that the gifts outlive the foregoing periods, the amounts involved do not form part of the estate and hence escape duty.

Even if the gifts are subject to gift tax there may be savings if the gift tax rates are lower than the succession duty rate (the interest factor should not be ignored in a precise comparison because the gift taxes are paid during lifetime and succession duties are paid at death).

The exemptions for gift taxes are measured, amongst other things, against one half the net of the prior year's taxable income less tax. This, together with the fact that gifts not exceeding \$1,000 to any one person each year are also exempt, means that a married man with a \$25,000 annual income could give away to four adult children over a ten year period at least \$100,000 without incurring any gift tax whatsoever. A reduction of \$100,000 in a moderate estate might save proportionately fairly large amounts of duty.

In many cases there may be significant savings even if gift tax is paid. For example, assume an estate of

\$1,000,000 is to be bequeathed to two children and the parent is in a position to reduce that estate substantially during his lifetime without upsetting his own way of life or scale of living. If the \$1,000,000 is passed on death to two adult children the succession duties (Dominion and Ontario) would amount to \$367,000 so that \$633,000 would remain for the children, or \$316,500 each. Now assume that the parent had made annual gifts of \$100,000 for four years, or a total of \$400,000 divided equally between the children. Gift tax might amount to \$14,450 per annum (assuming a \$15,000 gift tax exemption). In all, through gifts and gift taxes, the estate would be reduced by \$457,800 down to \$542,200. If all the gifts outlived the three and five year periods required, the succession duties would be levied on \$542,200 and would amount to \$165,370. In other words there would be \$376,830 available for the children plus the \$400,000 of lifetime gifts, or a total of \$776,830 as compared with \$633,000 above. Ignoring any interest factors, this procedure would have saved \$143,830.

It should be remembered that in the case of gifts to a spouse or to minor children, the income from the property donated is taxed in the hands of the donor. It is interesting to note, however, that the gross income arising becomes the property of the donee even though the tax thereon is paid by the donor. Neither the income nor the tax paid is considered to be a further gift. Since the income is not regarded as a further gift it can be invested separately and the further income which then would arise would not be taxed in the hands of the original donor. The cumulative effect of this treatment can be important over a span of years.

Because of the income tax situation surrounding gifts to a spouse, there is a tendency for persons to prefer to give property which is not income-producing. The place of residence is a popular piece of property to transfer to a spouse for this reason (also perhaps because this type of property cannot be frittered away at the race track). There are special and legal succession duty technicalities involved in the transfer of a residence which must be carefully explored. Further, if gifts are being made for the purpose of reducing an ultimate estate, there are great advantages in giving away those things which, over the years, are most likely to enhance in value.

#### PERSONAL CORPORATIONS

A personal corporation (one meeting certain tests described in section 68 of the Income Tax Act) may in certain circumstances have no income tax advantage, but might serve a very useful function so far as succession duties are concerned. Ordinarily the location or legal situs of property, as well as its ownership, determines whether a succession duty or an estate tax is imposed. Therefore a Canadian resident may be subject to succession duties or estate taxes levied by the United States and by one or more of the individual States, if he holds property in that country. For example, shares of a United States company transferable only in the United States might be subject to some foreign duties. Therefore if a person has substantial foreign holdings it would be advisable to consider transferring them to a personal holding company. In this way, only the shares of the holding company would be dutiable and hence any foreign duties could be avoided. It is true that

duplication of federal duties might be eliminated by the operation of reciprocal arrangements between the countries as laid down in the tax treaty, but this would not cover State taxes or duties. Even if no foreign duties were involved, because of local exemptions, the estate might nevertheless be precluded from disposing of or transferring the foreign asset until local clearances had been obtained. This procedure could be time-consuming and might also involve some expense.

Apart from the foreign duties angle, the freedom of movement provided by a personal corporation may make it well worth considering. All of its assets could be dealt with freely by the directors and management of the company, even though its shares were hopelessly tied up in estate red tape.

#### "FREEZING" OF ESTATE VALUES

Very often it is difficult to provide the liquid funds to handle succession duties and still carry out personal wishes regarding retention of estate assets. This problem is aggravated if the estate is a growing one, because the duty will be an ever increasing problem and the duty rates become progressively higher. Therefore there is often an advantage in fixing the level of an estate or "freezing" it, as the process is often called. One way of accomplishing this is to sell the assets which are apt to increase in value to a company formed by one's children or other prospective beneficiaries, taking back securities or obligations having a value which will not fluctuate. For example, at a time when market conditions were appropriate, a man might sell to a company formed by his sons all his investments in common shares, or at least

those with a growth factor and a real chance for future appreciation. He might take back some cash and some preferred stock or debentures, etc. In this way his estate value would become fixed and all future appreciation in the shares sold would accrue to the second generation, thereby escaping duties. There are a variety of technical problems involved and special circumstances will apply in each case, but the foregoing simple example will serve to illustrate the principle involved.

#### INSURANCE BY BENEFICIARY

The total size of an estate can also be kept down if it is possible to arrange that insurance protection which would otherwise be carried by an individual is instead taken out by his wife or children. This is of course easy when the wife or children have the necessary personal funds (perhaps from a grandparent for example) to pay the premiums on the policy. Care must be taken if the funds to pay the premiums are to be made available in some way by transfer or gift from the insured person.

#### Conclusion

It is hoped that by pointing up the problem in estate planning accountants generally might be reminded of the scope that is open to them. Practically every person has an estate or succession duty problem of some sort, but very few realize it or do anything about it. The chartered accountant is in a unique position to spot these problems, and with the cooperation of the experts in other fields — lawyers, insurance underwriters and trust officers — to render to the public a real service which will be fully appreciated because of its personal nature.

# Tax Aspects of Buying and Selling a Business

JOHN LANGDON

PRICE IS NOT always the deciding factor in the sale or purchase of a business. The primary consideration is how the seller stands taxwise after the deal is complete. Likewise the buyer is just as keenly interested in his tax position. If he buys shares he assumes the tax liability of the former owners. If he buys assets he is in a more favourable position as a rule. Whether it is the sale or purchase of stock or assets, the buyer and the seller have a common problem: can the deal be done on a tax basis favourable to both parties?

## Concept of "Designated Surplus"

Until a short time ago, when all inter-corporate dividends were free of tax except on winding-up, it was often attractive for one company to acquire another, especially if it was privately-owned. In effect, one corporation could buy the shares of another, pay out its surplus as dividends and then wind up the subsidiary. For the purposes of the tax on shareholders, the surplus was lost unless the parent had large capital profits. It was lost because, although the dividends were income to the parent for tax purposes, on winding up the subsidiary there was usually a corresponding deficiency in the amount treated for tax

purposes as a return of investment. The result was a capital loss on the liquidation of the investment which offset the dividend received. This situation, which in effect represented capitalization of undistributed income, was unacceptable to the federal tax authorities and led to the concept of "designated surplus".

"Designated surplus", a relatively new feature of the Income Tax Act, makes it definitely less attractive for one company to acquire another. Moreover, the Act makes it more attractive for a non-resident rather than a resident buyer to swing the deal. Designated surplus unquestionably has reduced the going value of a company, particularly where a private ownership is involved.

Many other factors have come into play making it more and more difficult to effect a change in corporate ownership without attracting a tax. Broadly speaking, the sale of a private company presents more problems than that of a publicly owned company. The reason for this is that ownership of a public company is spread over a large number of shareholders and the tax incidence is limited. On the other hand, the private company is controlled by a few, often family-owned,

and the tax problem constitutes a major issue.

Succession duties and income taxes have brought many Canadian businessmen to realize that owning a business is often a luxury they can ill afford. Consequently there has been more than a normal turnover in the ownership of private businesses which, in turn, has not been without its effect on our general economy. Of course, there are thousands of businesses in Canada which are still in private hands but it is a fair assumption that only a small percentage of the owners are fully aware of the vulnerability of their position.

Some of the more far-sighted owners have taken the advice of their auditors and legal counsel to protect themselves and in turn their estates. But more, seemingly the majority, have no clear-cut plan of how to protect their businesses from enforced sale at a sacrifice price in order to pay succession duties.

#### **Pattern of Private Ownership**

The record of the average owner of a private business follows a more or less set pattern. He formed his company with a modest capital 20 or 30 years ago; the business has prospered. He has taken a good living out of it, but most of the retained earnings in the way of depreciation and surplus profits have been ploughed back in the form of plant, machinery, inventory and accounts receivable. Liquid resources in the form of cash and marketable securities are seldom more than enough for ordinary operations. The earned surplus has grown until it now amounts to a considerable size and cannot be taken out without attracting substantial taxes.

The problem of the owner of a private business is particularly acute

if he has not sufficient resources outside of the business to provide for succession duties. Then, too, what are the succession duties if the business is the principal asset in his estate? If the business is incorporated, the stock is not traded in publicly, and hence there is no recognized market value for succession duty purposes. Even where stock is made available to employees at a fixed price, there is no assurance that such values will be admitted by the governments concerned. Nor is there any formula or regulation laid down by the Federal, Quebec or Ontario Governments which would enable the owner of a business to calculate the value of his property for succession duties. He is literally at the mercy of the taxing authorities as to what value will be placed on his holdings.

Where an owner has built up resources outside his business there may be no problem. But what about the owner who ploughed earnings back into his business to take care of expansion? His position became so serious that the Federal Government recognized his plight by creating a Royal Commission, known as the Ives Commission, to investigate and make whatever recommendations it considered necessary to alleviate the situation.

#### **Capitalization of Earned Surplus**

On the recommendation of the Ives Commission, the owner of a private business was permitted to capitalize the earned surplus on payment of a special tax. Later this privilege was broadened out by section 95A of the Income Tax Act in respect to surplus accumulated to the end of 1949, and still later by section 105A. While this gave a measure of relief, the imposition of other restrictions has not made



the lot of private ownership any easier.

The ability to capitalize earned surplus without attracting a confiscatory income tax unquestionably has been helpful, but the problems of the owner of a private business are far from being fully solved. Capitalization of the earned surplus has, in many cases, failed to put tax-free cash in the hands of the owner. In some cases he has borrowed from his banker or created and sold debt securities to provide the cash funds to redeem the preferred stock arising from capitalization of the earned surplus. Or again, the tax-paid surplus has been created and left undisturbed as the cash position did not warrant redemption of the newly created preferred stock.

Faced with a realization of the problem, a large number of private businesses have changed hands in the last few years. Such sales have not been easy to effect. Where a large earned surplus existed, the owners wanted to sell stock in order to avoid payment of the tax incurred when such surplus was capitalized. Quite often the owner looked at the depreciated value of his fixed assets and sought to sell his stock on a replacement basis. Then, too, many an owner estimated the value of his company and in turn the stock by taking his peak earnings and multiplying by "X". "X" was the number of times earnings that the listed stock of a publicly owned company in a similar line of activity was fetching on the open market. In other words, most owners have endeavoured to get for their business a price far beyond the most optimistic figure they would set down for succession duty purposes.

So much for the attitude of the seller. Naturally the buyer has his

own ideas as to value. In nearly every case he would prefer to buy fixed assets so that he could depreciate from a level much above book value. If he bought stock, he had to take into consideration, among other things, existing and potential tax liabilities.

### The Paradox of Tax Implications

The real bugbear of the owner of a business is not so much succession duties as his position under the Income Tax Act. The Act as constructed and applied today has created a situation whereby the interests of the vendor and purchaser are diametrically opposed at all points. Should a vendor or purchaser be ignorant or ill-advised, the tax problems set up to enforce this opposition of interests are so severe that they amount to confiscation.

For many reasons, such as age or incapacity of the owners, private businesses must be sold. Most purchasers of such businesses expect to make the purchase profitable by improving efficiency. This is desirable from the standpoint of the economy. The Act should impose as few difficulties as possible on such transfers but unfortunately many deals fail to be consummated because of the tax implications.

Paradoxically, it is usually advantageous for the purchaser to buy assets but for the vendor to sell shares. The purchaser who buys assets is allowed capital cost allowance on the price he has paid for the properties and avoids tax and other liabilities relating to the vendor company. But when the vendor sells assets, the disadvantages to him are many. He is subject to recapture of depreciation which under today's conditions represents taxation of changes in the value of the monetary unit rather than a

real profit. He is left with the problem of disposing of the undistributed income on hand and, unless he is willing to proceed slowly and through many devious steps, he could find this extremely expensive because of progressive tax rates.

If shares rather than assets are sold, the advantages to the vendor are that he can obtain his profit, often attributable to a policy of retaining earnings, as a capital gain and he is free of all tax liabilities. On the other hand the purchaser, although he may have paid a substantial premium over book value because of the effect of inflation on the value of the properties, cannot amortize that premium as a cost deductible for tax purposes over the life of the properties.

The purchaser also is faced with the designated surplus, a distribution of which costs him a tax of 15% if he is a U.S. or U.K. parent plus, where applicable withholding taxes of 15% or 5%; a tax of 20% if an investment company; and the extremely arbitrary rate of 47% if a resident corporation.

#### **Other Points to Consider**

It is often said the designated surplus is no problem when the shares of a Canadian company are purchased by another Canadian company. The subsidiary can be continued and if dividends are restricted to post-acquisition earnings no serious consequences ensue. However, if post-acquisition earnings are meagre or non-existent, any cash accumulations of the subsidiary are not available to the parent by way of loan unless the loan is routed through another company.

Where a company acquired another company through the purchase of stock, it was possible until recently

that the purchaser could take out the cash accumulation of the acquired subsidiary in the form of a tax-free dividend and use the proceeds to pay in part for the shares purchased. This transference of a tax liability from one company to another did not deprive the government of revenue. It resulted only in a deferment of the tax. However, today such an arrangement does attract tax.

Again, where a company finds it necessary to issue bonds to provide funds for the purchase of another company's shares, interest on the bonds is disallowed as an item of expense. In substance, from the group standpoint this represents replacement of capital equity with creditor capital. If an individual were to do this, the interest would be deductible as an expense. Formerly the subsidiary could be wound up and interest on the bond issue would thereafter be allowed, but designated surplus now prevents this move.

While the greater part of this article has been devoted to the position of the owner of a private business, many of the points raised apply with equal force to a publicly-owned company. The designated surplus and its application tax-wise have certainly made it less attractive for one company to acquire another. Those responsible for changes in the Income Tax Act and its application have been concerned with collecting a tax on earned surplus when the ownership of a company changes hands rather than with the effect of such a change in strengthening the economy. Our economy cannot remain static and the tax authorities should aid, not hinder, changes in corporate ownership, which by broadening the base of operations will lead to improved efficiency and earnings.



## C.I.C.A. ANNUAL CONFERENCE, 1956

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The annual conference of the Canadian Institute of Chartered Accountants, the 54th meeting in its history, was held in Halifax, N.S. on September 10, 11 and 12, 1956. As forecast earlier, it was well up to the tradition of success established by the conferences of the past two years.

On Monday morning, September 10, James C. Thompson, C.A., a past president of the Institute of Chartered Accountants of Quebec, gave an address on "Widening Horizons for the Chartered Accountant". Mr. Thompson said that there is no greater challenge today to professional accountants than the problems arising in the field of management controls.

He said in part: "Management controls are not a new field but are assuming increasing importance in the profession. Management, always cost conscious, is constantly seeking ways and means of reducing and streamlining accounting and clerical procedures. It is an ever widening field. The chartered accountant brings to his task a wealth of experience gained over the years in his examination of all types of business. He is able to advise and assist management in establishing controls and methods of reporting, essential to successful administration. There is no greater challenge today to professional accountants than the problems arising in the field of management controls. This is the machine age but we should remember that machine bookkeeping and electronic devices will never

reach the stage where they will run by themselves and replace the trained observer. They are simply tools of our profession and need professional skill and intelligence to use them to advantage."

Mr. Thompson said that the same challenge existed in governmental activities. Government deficits may be met by new borrowings, by increasing taxes or by reducing services and cutting the costs of administration. The costs of government should, therefore, be under constant scrutiny in order to provide maximum service at minimum cost. The chartered accountant can make a great contribution to this objective.

Mr. Thompson reminded his audience that since the enactment of federal tax legislation the services of a chartered accountant have been practically indispensable to every taxpayer, and that as a result of the efforts of the profession either as individuals acting for clients or through briefs presented under the joint auspices of the Canadian Institute and the Canadian Bar Association, many taxation inequities have been remedied.

The final theme of Mr. Thompson's address was the part that chartered accountants can play in maintaining the business health of our country. He said that no one is better equipped than the professional chartered accountant to appraise the value of business either for a prospective vendor or purchaser. He may be called upon to act for either party and with

his wide knowledge and experience he will be able to protect his client from the many pitfalls which await him.

Dealing with the form and content of financial statements, Mr. Thompson said that the profession should continue to encourage management to produce financial statements comparing operations for the year under review with those of the previous year. Information should be summarized, supporting details being supplied in schedules. The profession owes a duty to the public and to its members to simplify the presentation of financial statements. It is accustomed to the technical language of the profession, and understands it, but to the public it is a complete mystery.

Mr. Thompson's address was followed by another by V. W. T. Scully, C.M.G., F.C.A. who spoke on the contribution of the professional chartered accountant in industry.

He said in part: —

Today the chartered accountant has become a premium product as sought after and as scarce as the engineer. This, of course, is a good thing, principally because it demonstrates the awakening of business men to the realization that well trained accountants are about the most useful men that commercial and industrial enterprises can employ. The accountant has outlived and outgrown the bookkeeper concept. He is accepted as an equal by the very class of industrial society which not very long ago had a sort of tolerant contempt for the fellow who juggled figures. The accountant has forced this change principally by making himself useful, by leading the parade of progress, and by readily adjusting his thinking processes to new ideas. He has not abandoned tradition but neither has he tried to preserve the outmoded.

From loose-leaf ledgers to bookkeeping

machines, to punch cards, to electronics, all in the space of a generation, is no mean accomplishment and certainly one that has brought to our institutes much lustre and praise. The changes in accounting methods have been very rapid and the job of collecting and recording accounting data is now being done in many companies by people who have no knowledge whatever of the system of double entry which sustained us and mystified others for so many years. The emphasis is now on the use of figures for management — standard costs, the principle of managing by exception, budgetary control, forecasting and, perhaps most important of all, forward planning.

Industry does not expect young accountants to be experts, but it does expect them to realize there is little room left in large companies for ledger keepers. The accountant in industry is perpetually confronted with problems in systems and procedures. Rising costs focus attention on the need for control and in the accounting department should be men who know where to look for causes, men able to join forces with others in finding the best correctives.

Generally speaking, young accountants coming out of professional practice expect immediate financial improvement and rapid advancement. It is safe to say that the majority find both. I think it has been clearly demonstrated in Canada that accountants are quite capable of becoming good executives. A great deal has been written and said in recent years about executive development. Indeed, great efforts are being made to find and train men with executive potentials. The young chartered accountant has usually taken several of the essential preliminary steps. He has a knowledge of finance, statistics, economics, budgets, banking, taxes, and a great many other things that competitors from other professions do not have. He is weakest on human relations and this is a field he cannot overlook. Leadership is essentially the ability to win the confidence of others and the successful

executive must have it. It is not to be measured by technical skill. It is really a sense of liking, trusting and being interested in people.

There are also good openings in large companies for accountants who want to continue in audit work. Internal auditing is not quite the same function as that performed by practising accountants, but it requires the same kind of skill and training. One of the benefits that accrues to the individual in the internal audit department is that he gets a close inside look at the whole business in a very short time. For an ambitious young man this can be important when he is considering where he is going.

There is another field in industry that is being much talked of nowadays and for which the accountant is well qualified — "Operations Research". This consists of tools and techniques for resolv-

ing problems involving many variables. The mathematics needed may be very advanced or may be quite elementary, depending upon the kind of problem. The practical use, however, of operations research techniques can lead to more precise answers in many business situations. It promises to be a valuable aid to management decision-making in the future. It is particularly helpful in controlling inventories and in production planning. The chartered accountant who intends to go into large industry and who has a flair for mathematics will find the study of operations research a challenging and profitable activity.

Forward planning will provide practically infinite scope for the accountant in industry. Where, when and how investments should be made will involve most companies in grave decisions of



**THE INSTITUTE'S OFFICERS FOR 1956-1957**

The new officers of the Canadian Institute of Chartered Accountants posed for this photograph upon their election on Tuesday, September 11. Left to right: seated, J. L. Helliwell, B.C.; 2nd vice-president; G. E. Martin, N.S., immediate past president; W. Givens Smith, Sask., president; J. A. de Lalanne, Que., 1st vice-president; E. M. Howarth, executive secretary. Back row, left to right: R. W. Manning, P.E.I., regional representative; J. G. Duncan, Alta., regional representative; J. A. Wilson, Ont., regional representative; T. A. M. Hutchison, Toronto, treasurer.

J. C. Thompson, C.A., a past president of the Institute of Chartered Accountants of Quebec, speaks for the profession in practice on widening horizons for the Chartered Accountant.



A group of C.I.C.A. past presidents who have served the Institute well and truly over many years are H. E. Crowell, Halifax, W. J. Macdonald, Winnipeg, J. G. Glassco, Toronto, H. R. Doane, Halifax, F. A. Nightingale, Halifax. Mr. Crowell was the Institute's President in 1929-30.

PANEL ON POST-GRADUATE DEVELOPMENT OF THE C.A. Left to right: D. W. McKinnon, P. S. Ross & Sons, Montreal, C. D. Mellor, Executive Secretary, Quebec Institute, G. F. Davis, Hydro - Electric Power Commission of Ontario, Toronto, J. L. Helliwell, Helliwell, MacLachlan & Co., Vancouver, W. R. Corner, C.N.R., Winnipeg.



Members in industry, government and public practice are represented in this group at Dalhousie, left to right: L. J. Mills, Post Office Department, Ottawa, W. H. Flynn, Canadian Industries Ltd., Montreal, M. I. Stevenson, Office of the Auditor General, Ottawa, P. Rising, Vancouver.

V. W. T. Scully, F.C.A., vice-president and general manager of the Steel Company of Canada, speaking on widening horizons for the chartered accountant from the viewpoint of industry.



PANEL ON  
MANAGEMENT CONSULTING  
Left to right: D. L. Gordon, Clarkson, Gordon & Co., Toronto, R. Wellington, Scovell, Wellington & Co., New York, C. W. Leach, McDonald, Currie & Co., Montreal, J. A. Wilson, George A. Touche & Co., Toronto, R. C. Berry, Montreal.

A group deep in conversation at Dalhousie are F. W. V. Anderson, Northern Electric Company, Montreal, J. G. Simonton, Calgary, M. Laird Watt, Montreal, D. C. Macdonald, Moncton.



The Lieutenant Governor of Nova Scotia presents the Governor-General's Gold Medal to John E. Sands, Toronto, top candidate in the uniform final examinations.



Piping hot lobster at Hubbards! Left to right, below: Mr. and Mrs. A. W. Bruce, Montreal, W. R. Clerihue, Montreal, G. W. Woods, Vancouver, C. D. Fraser, Montreal.

Above: J. G. Brown, Kitchener, A. D. P. Stanley, Vancouver.



In the line up for the buffet supper on September 11, left to right: G. H. Spence, Toronto, Mr. and Mrs. W. I. Hetherington, Toronto.

At closing dinner and dance, receiving the guests were Gerald E. Martin, retiring president, Mrs. Martin, W. Givens Smith, incoming president, Mrs. Smith, G. A. Finlay, president of the Nova Scotia Institute and Mrs. Finlay.



#### A VISIT TO H.M.C.S. CRUSADER

Left to right: G. D. Iliffe, Winnipeg, Mrs. W. F. Martin, Mrs. G. D. Iliffe, W. F. Martin, Vancouver, Mr. and Mrs. T. M. Chase, Toronto, Mr. and Mrs. L. J. Mills, Ottawa.



far-reaching importance. In the economic appraisal of such ventures the accountant will have a key role. His training, knowledge and judgment will complement the skill and judgment of the engineer and the economist in the examination of expansion problems and investment opportunities. It may well prove that the accountant's most valuable contribution to the fulfilment of this country's destiny will be his ability to organize and direct examinations of this type.

The accountant in industry will also find himself involved in industrial relations. Usually he has no part in the actual operating side but because nearly all industrial relations problems have a monetary aspect, he complements in a most valuable way the specialists who handle union negotiations, wage rates, fringe benefits, etc. It is important for the accountant to be well informed on these matters since they affect costs and inevitably product prices.

Taxation, of course, has become a field in which the accountant tends to consider himself an expert. It is a fact that few important decisions can be made in business affairs today without fully considering the effects of taxation. Practically all business tax problems have an accounting aspect and therefore the accountant in industry must have or acquire some considerable knowledge of income, sales and excise taxes, municipal taxes and tariffs.

Finally, it would be remiss if I did not make a brief reference to the opportunities for accountants in government service. Chartered accountants are to be found in many departments of all governments and many of them have attained high office. They have enhanced the reputation of our profession and we are fortunate that for somewhat unrewarding monetary considerations they continue to serve us.

The pace of our advance has been rapid and accelerating. By every criterion we know of, the pace should continue bringing greater scope and more

challenging problems. Our institutes, to stay in the forefront, must be creative and progressive, fostering the widest confidence in their integrity and attracting to their ranks able and conscientious young men and women who will carry on the work so well begun by our founders.

The morning sessions were followed by a Nova Scotia Government luncheon for members which was presided over by the Hon. Henry Hicks, Premier of the Province. The guest speaker was the Hon. Robert Winters, Federal Minister of Public Works, who spoke on housing in Canada. Mr. Winters said that since the end of World War II one million Canadian homes had been completed and that Canada leads the world in per capita home ownership. The real income of Canadians, per capita, has gone up by more than 70% in the last 15 years and the increased use of the automobile has resulted in our present high degree of urbanization and the equally high degree of home ownership.

Three concurrent panel discussions in the afternoon proved particularly stimulating for discussion on matters of interest to members in practice. Topics covered "Significant Changes in the Course of Instruction", "The Post-Graduate Development of the Chartered Accountant" and "The Development of an Accounting Practice".

This was followed in the evening by a visit as guests of the Royal Canadian Navy, to a destroyer, H.M.C.S. Crusader in Halifax Harbour. The president, other officials of the Canadian Institute and distinguished guests were received in the captain's cabin by Rear Admiral R. E. S. Bidwell, C.B.E., Flag Officer, Atlantic Coast. Members and their ladies later enjoyed an excellent buffet supper at the Nova Scotian Hotel.

At the morning session on Septem-



ber 11 at which the chairman was William Hogben, C.A., an address on "Human Relations in Administration" was given by W. G. Mann, personnel adviser of the Bank of Montreal. Mr. Mann said:

Human relations is not something to be turned on and off at will in order to give a company staff a shot in the arm when morale is low. Human relations is the effective understanding of human reaction. Mentally and physically no two persons are alike. Their various urges are different in variety and intensity even though their motives and impulses may be the same. Human relations is the understanding of these impulses.

On every side I seem to be running into the interpretation of human relations as being something paternalistic, protective, or cradle to the grave philosophy and then some doubt arises about human relations because the particular philosophy does not seem to be solving problems. No one ever gains any feeling of respect or importance when his gains are through paternalism. He gains in importance and maturity when the rewards are for work well done and the majority of people prefer equity to generosity.

In Canada we have millions gainfully employed and each with a relationship to the other in the daily process of earning a living. These relationships are human relationships, vital to our well being and that of the community.

I wonder if the broad rule that a chartered accountant can play in industry, either in his capacity as auditor or comptroller, is fully realized. It does seem to me that the interpretation of human relations in his field of work could not only be profitable but rewarding. Over the last thirty years the tendency has been away from the teaching of the humanities. The emphasis has been on science or commerce and may I especially suggest that the humanities have received little attention in the Schools of Commerce and Accountancy.

What are the characteristics necessary for sound working relations — human relations? They are ability to compromise, ability to make up one's mind, acceptance of responsibilities, objectivity, the need for a broad outlook on life, not marred by prejudices, ability to act without mental confusion. These are all keys to a mature person and psychological immaturity is something that can never be forgiven in an executive because it is like a stone in a pond, the ripples go on to affect and disturb too many people.

The business session on Tuesday ended with the annual general meeting for the report of Council, the treasurer's report and the re-election of the auditors.

Six discussion groups of interest to members in practice and industry were held at Dalhousie University on Wednesday, September 12 and were followed by an afternoon panel discussion on management consulting and a roundup panel.

The closing dinner and dance presided over by Gerald E. Martin was held on Wednesday evening at the Nova Scotian Hotel and attended by nearly 400 members and ladies. The distinguished company included His Honour the Lieutenant Governor and Mrs. Fraser, Rear Admiral and Mrs. R. E. S. Bidwell, Major General and Mrs. E. C. Plow, Mayor Kitz and Mrs. Kitz, Dr. A. E. Kerr, president of Dalhousie University and Mrs. Kerr and Canon H. L. Puxley, president of the University of King's College and Mrs. Puxley.

Mr. Martin paid tribute to all those who had been associated with him during his term as president and acknowledged the fine work of the Annual Meeting Program Committee under the joint chairmanship of W. C. Leach and Hugh Spencer. The retiring president then introduced the

*Continued on page 354*

# Accounting Research

The C.I.C.A.  
Research Department

## LONG-TERM LEASING

Long-term leasing is by no means a current development, but the extension of this practice as a primary financing device has attained substantial significance only since World War II.

The earliest form of leasing agreements were those pertaining to the long-term use of agricultural lands. Later, during the industrial and commercial developments of the 18th and 19th centuries, there was a gradual concentration of population in urban communities. Long-term land leases played an important role in the development of these towns and cities. By the early 1900's most of the leasing agreements in both Canada and the United States covered lands in urban commercial districts. Even today many of the buildings in the business sections of our cities occupy land which is held under the provisions of a long-term lease rather than outright ownership. "It is generally conceded among real estate authorities that much of our urban commercial development would not have been undertaken if suitable locations had not been available on a long-term lease basis."<sup>1</sup>

In the field of retail undertakings, mining developments and specialized equipment construction, long-term

leases achieved a fair degree of importance during the period from 1915 to 1939. However, it should be noted that during this period, this practice was confined to rather special circumstances and that "the primary motive for electing the leasing alternative was frequently to take advantage of the legal differences between the lease and the sale rather than to use the lease primarily as a method of financing".<sup>1</sup>

## Post War Developments

The evolution of the leasing device as a method of financing was the direct product of two powerful forces in operation on the capital market in the years following World War II. On the one side, there was the tremendous demand by business enterprises for increased working capital and larger physical plant to provide the goods and services necessary to an expanding peacetime economy. Traditional financing techniques, because of their limitations and because of the volume of financing required, did not provide an adequate solution. Business enterprises were therefore looking for new methods of tapping the capital market.

On the supply side, there was the ever-increasing balance of liquid funds which institutional investors, particularly the life insurance companies, were seeking to place in suitable income producing investments.

<sup>1</sup> A. H. Cohen, "Long-Term Leases—Problems of Taxation, Finance and Accounting".

The entry of these investors into the area of direct ownership of properties held for the production of income in the form of rentals, previously prohibited because of statutory limitations, provided for the expanding corporations a much needed alternative method of external financing.

In the United States, the trend towards lease financing has achieved significant proportions. In its annual study, "Accounting Trends and Techniques in Published Corporate Annual Reports", the American Institute of Accountants showed that 232 of the 600 survey companies referred to, or implied, the existence of long-term leases in their reports for 1954.

On the other hand, in Canada, the progress in the development appears to be somewhat slower. Of the 287 companies whose annual reports for 1955 have been analyzed to date, only 57 referred to, or implied, the existence of long-term agreements. There may, of course, be many other companies who have entered into leasing contract but who have not elected to disclose this information in their annual reports.

The Life Insurance Institute in the United States reported that as early as 1946, the total life insurance investment in commercial and industrial properties had reached the \$80,000,000 mark. This was as a direct result of the broadening of the State laws regulating investments in real estate by insurance companies and educational and philanthropic trusts. Similar broadening did not appear in Canada until 1948, and at that time it was on a very limited basis. In 1948, section 60 of the Canadian and British Insurance Companies Act, 1932 was amended to permit Canadian companies to acquire investments not fall-

ing within the regularly prescribed classes but the total of such investments was limited to 3% of the book value of the company's total ledger assets. In 1950, extensive amendments to the investment provisions of the Act were made which had the effect of bringing within the regularly prescribed classes many of the investments that had been made under the authority of the 1948 amendment.

A recent survey of the assets of Canadian life insurance companies, made by the Canadian Life Insurance Officers Association, showed that in 1954 there was a total of \$80,000,000 of real estate held by life insurance companies for income purposes. It is rather unusual that this is the same figure as was reported in the United States for 1946. Although the 1955 survey is not yet completed, it is anticipated that the total income producing real estate held by Canadian life insurance companies will reach \$100,000,000. However, when we compare this with an anticipated figure of \$5,570,000,000 for the total assets held by these companies, it is apparent that leasehold transactions make up only a very small proportion of the activities of life insurance companies in this country. In addition, it has been reported that practically all of the real estate lease agreements have been made with service stations and retail chain stores.

#### **Sale and Lease-Back Agreements**

The most popular form of agreement to emerge from this trend towards lease financing is the so-called "Sale and leaseback" contract. Under this technique, the investor purchases outright certain properties under a contract in which the seller agrees to continue uninterrupted occupancy

under the provisions of a long-term lease. A modification of this type of contract consists of an arrangement under which the lessor constructs a building to the specifications of the lessee. Buy-build-sell-and-lease transactions are also extensions of the leaseback technique in which the purchaser of land builds to his own specifications, sell the improved property and simultaneously leases it for a period of years.

Originally identified with retail chain stores having extensive real estate holdings, sale and leaseback financing has spread among other corporations which have a substantial portion of assets tied up in buildings, warehouses or other fixed assets and is now used in a wide variety of business situations.

### Advantages

From a business standpoint, certain definite advantages may be derived from the selective use of the sale and leaseback agreement. The leasing device makes it possible for management to maintain an adequate level of plant facilities without impairing the working capital position of the business and without incurring the usual limitations and restrictions which accompany traditional financing techniques (capital stock issues, bond indentures, mortgage loans, etc.).

Long-term leasing has frequently been noted as a means of avoiding the threat of obsolescence. The ability to sub-let properties which no longer effectively fulfil their useful service provides management with an escape from the threat of being trapped in an uneconomic position by ownership.

The tax aspect of leasing cannot be ignored. There are certain advant-

ages which may accrue with this method of financing over direct ownership financed by borrowing funds. Under a lease plan, an enterprise may be allowed to deduct the total annual rental paid to the lessor for the use of productive facilities as an operating expense in determining its taxable income. On the other hand, under direct ownership, the enterprise is allowed to deduct the sum of the interest paid on borrowed funds and the capital cost allowance on depreciable facilities. Since the lease terms are usually set to return the cost of the assets plus interest during the primary lease, the lease plan may make it possible to report the cost of using assets more rapidly than does depreciation under ownership. In addition, annual rental charges take into consideration the amortization of land costs which are not allowable as an expense under direct ownership. However, the inclusion of a repurchase clause in many of the contracts may eliminate the possibility of current tax savings. The Income Tax Department may view a leaseback with a repurchase clause as a form of instalment purchase. Instead of being able to deduct the rent payable under the term of the lease, the lessor may be allowed to deduct only depreciation based on a capital value arrived at by special formula.

### Statement Presentation

Long-term leasing agreements create problems of disclosure in the financial statements of the leasing company. Leasing results in a commitment which is, in effect, a pledge of credit presently not reflected in the books or statements, as well as long-term fixed charges against revenues

which are not recognized until the actual payment is made. In the early years of the development of this device, it was suggested that the balance sheet might include among its fixed assets the present value of leasehold obligations with a corresponding long-term liability. It was also suggested that the disclosure of this information might be made by means of a footnote.

In October 1949 the Committee on Accounting Procedure of the American Institute of Accountants made specific recommendations relating to the disclosure of long-term leases in the financial statements of the lessee. These recommendations, reconfirmed in 1953 in the Restatement and Revision of Accounting Research Bulletins, were as follows:

The committee believes that material amounts of fixed rental and other liabilities maturing in future years under long-term leases and possible related contingencies are material facts affecting judgments based on the financial statements of a corporation, and that those who rely upon financial statements are entitled to know of the existence of such leases and the extent of the obligations thereunder, irrespective of whether the leases are considered to be advantageous or otherwise. Accordingly, where the rentals or other obligations under long-term leases are material in the circumstances, the committee is of the opinion that:

- (a) disclosure should be made in financial statements or in notes thereto of:
  - (1) the amounts of annual rentals to be paid under such leases with some indication of the periods for which they are payable and
  - (2) any other important obligation assumed or guarantee made in connection therewith;
- (b) the above information should be given not only in the year in which the transaction originates but also as long

thereafter as the amounts involved are material; and

- (c) in addition, in the year in which the transaction originates, there should be disclosure of the principal details of any important sale-and-lease transaction.

Since the lessee in such cases does not have legal title to the property and does not necessarily assume any direct mortgage obligation, it has been argued that any balance sheet which included the property among the assets and any related indebtedness among the liabilities would be incorrect. However, the committee is of the opinion that the facts relating to all such leases should be carefully considered and that, where it is clearly evident that the transaction involved is in substance a purchase, the "leased" property should be included among the assets of the lessee with suitable accounting for the corresponding liabilities and for the related charges in the income statement.

The necessity for the disclosure in the financial statements or in notes thereto of information with regard to long-term leases is also discussed in Rule 3-18(b) of Regulation S-X issued by the Securities and Exchange Commission. This rule reads as follows:

Where the rentals or obligations under long-term leases are material there shall be shown the amounts of annual rentals under such leases with some indication of the periods for which they are payable, together with any important obligation assumed or guarantee made in connection therewith. If the rentals are conditional, state the minimum annual amounts.

The 1955 edition of "Accounting Trends and Techniques" indicates the extent and manner in which the American companies included in the survey have complied with these recommendations. In referring to the 232 companies indicating the existence of

long-term leases, this survey stated that:

One hundred and fifty of these companies merely mentioned or indicated that such leases existed but did not furnish any details with regard to them. The remaining 82 companies in this group set forth in varying degrees and combinations such factual data as the amount of the annual rental, the aggregate rental, the term of the lease or its expiration date, the number of leases, information as to renewal options, and details as to sell-and-lease-back provisions. The foregoing information was usually presented in the footnotes to the financial statements.

Because these financing techniques are, in effect, still in the initial stages of development in Canada, there has not yet been a clear cut statement as to the proper procedures of disclosure. However, the Committee on the Canadian Companies Act of the Canadian Institute of Chartered Accountants made some recommendations in this respect. The report of this committee, which was released in February 1953, included the following recommendation:

Where applicable, the following matters shall be referred to in the financial statements or by way of note thereto:

- (d) Material contractual obligations in respect of long-term leases, including, in the year in which the transaction was effected, the principal details of any sale-and-lease transaction.

Clause 4 of section 87(2) of the Ontario Corporations Act, 1953 is identical to the above recommendations. Therefore, Canadian companies incorporated under the laws of Ontario are now required to make such disclosures in their annual report.

The following summary was prepared from the analysis of the annual reports for 1955 of 287 Canadian companies:

## DISCLOSURE OF LONG-TERM LEASES

	No. Cos.
Setting forth details of long-term leases	16
Mentioning long-term leases but omitting details	3
Indicating long-term leases without mention thereof by reference to leaseholds or leasehold improvements	31
Indicating apparent existence of long-term leases by reference to leases of undisclosed terms and various other matters	7
	<hr/> 57
Neither referring to nor indicating long-term leases	230
	<hr/> 287

The reports of the 16 companies in the first classification set out varying degrees and combinations of data similar to that in the American survey. The following summarizes the types and location of information in these reports:

	Details set out in	
	Directors'	
Type of information	Footnotes	Report
Annual rental amount	9	
Aggregate rental amount	5	
Lease expiration date	7	
Number of leases	2	
Term of lease	4	
Renewal options	3	
Sell-lease-back features	3	3

The following are references from the reports of Canadian companies:

- (1) *In note to financial statement*  
 "During the year ended 31st December 1955 certain recently erected branch properties were disposed of for an aggregate consideration of \$261,000 and long-term leases were entered into for the same properties. The obligations in respect of these leases as at 31st December 1955



were \$513,152 and covered a period extending to 1985."

(2) *In directors' report*

"With the cooperation of leading life insurance companies your management continued its policy of selling store properties and taking back long term leases. At the end of the fiscal year your company had commitments from these institutions to purchase and lease back a number of store properties totalling \$3,061,259.

"It is the intention of the management of your company to continue the 'buy-build-sell-lease' policy. We are happy to acknowledge the participation of the life insurance companies in this type of financing which we believe affords them not only a sound means of investment but also the opportunity of joining your company in its efforts to reduce the cost of food distribution."

(3) *In directors' report*

"Net additions to fixed assets during the year were \$5,974,716, although a considerable portion of these expenditures will be recovered in cash when the stores now under construction are completed and sold under lease-back agreements. During the fiscal year and since the close of the fiscal year, your Company has sold 25 store properties to . . . . Leased Properties Limited for a total consideration of \$8,960,000, and has taken back long-term leases on a favourable basis. The balance sheet reflects the partial completion of this transaction."

*In notes to financial statements*

"3. The company's contractual obligations with respect to

long term lease agreements which extend beyond five years from the balance sheet date aggregate approximately \$30,200,000.00. During the year ended May 28, 1955, certain store properties were sold for an aggregate consideration of \$6,962,127.00 and long term leases were entered into with respect to the same properties.

"6. The preference shares of . . . Leased Properties Limited were paid for in cash to the extent of \$120,000.00 and as to \$1,000,000.00 were received as partial consideration for sales of real estate to that company. A surplus over book value of such real estate in the amount of \$703,251.00 was realized in this way and forms part of the surplus from the sale of real estate credited to earned surplus and the subsequent transfer to the real estate carrying charge reserve.

"7. The real estate carrying charge reserve originated from the excess of sale price over depreciated cost of certain land and buildings sold and is being amortized over the periods of long term leases entered into by the company on the respective properties. It is the present intention of the company to continue this practice. Additions of \$896,719.00 and a sundry adjustment of \$1,734.00 were credited to the reserve during the year under review and amortization charges amounted to \$73,567.00."



# *Administrative Accounting*

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## CONTROL OF EXPENSES

Control of expenses is an essential part of the operation of any business and hence also of the function of management at all levels in the business. In the course of time, many devices have been used to assist management in this task. Some have been good; a great many have had major shortcomings. All, however, must fulfill one basic requirement to achieve any degree of success. They must present to management a predetermined yardstick against which to measure current performance.

The most widely used and successful method of controlling expenses is a budget program. In the overall sense, a budget may be described as a road map showing the probable course of the business for a specified period, based on knowledge of the broad aims and policies of the business and the best available estimate of general trends and economic conditions. It will consist of a number of more detailed plans dealing with specific phases of the operation, and here expense budgets are found. Usually there will be at least three separate budgets covering selling, advertising and administrative expense, respectively. Their mechanics may vary widely among different types of businesses, but essentially they will be based on a combination of known facts and estimates which may have a high degree of accuracy or which may be little better than informed guesses.

The important thing is that they do represent a planned course of action, and thus offer a yardstick against which to measure actual results.

Once a program of this type has been instituted, the first step in the control of expenses has been taken. Obviously, however, this is not enough. In order to reap any real benefits, some procedure must be devised to ensure a constant review of the results versus the plan and to take corrective action as required. Furthermore, the budget itself must be constantly revised to reflect changing conditions.

The organization necessary to operate a system of this type will vary greatly with the size and complexity of the operation and also with the degree of refinement reached. In most cases, it will be a function of the accounting unit, since it is here that the individual plans prepared for the various segments of the operation will have been consolidated into the master plan. This does not mean, of course, that all the work or staff involved in the preparation of the budgets, etc. will belong to the accounting unit. In fact, each unit of the organization is responsible for its own plan and accordingly will have its own staff as required to perform this function.

The second phase, i.e. interpretation, can be the most important since it determines the program's final value to the organization. Drafting and pre-

senting a plan of action does contribute to the efficiency of operations, but full value is obtained only when management uses the tool provided. Thus it is of prime importance to interpret correctly the comparison of actual results with the budget. Only then can proper corrective action be taken.

In discussing expense budgets we are dealing with only a very small part of the large overall plan for profits. The whole, however, is only as good as the parts, and therefore proper orientation of the expense budget is necessary before its full importance can be realized.

The first expense budget, selling expense, is probably the most straightforward to prepare. Once the anticipated level of sales has been agreed the expected workload can be measured with a relatively high degree of accuracy. This in turn will determine the size of the staff required, amount of travelling involved, etc. Next, a detailed budget by expense classification should be developed, including separate budgets for any branch offices. Depending upon the organization and the internal controls in effect, it may also be desirable to make a further breakdown by product in order to prepare product profit and loss budgets. Most budgets will be formulated for a 12-month period, and will almost invariably cover more than one month. Hence they must be further broken down by whatever period is normally reported on in order that accurate comparisons with actual results can be made in due course. Great care must be taken to charge the proper amount of each budgeted expense to the month or period in which it will be incurred. The individual sales managers must review the budgets applying to their operations.

The second expense budget, adver-

tising, presents certain additional problems. Normally, it will be divided into two main classifications: (1) the direct cost of operating the advertising department and (2) the cost of the various advertising programs such as space, art work, printing, etc. The budget should reflect both types of expense separately.

Normally, advertising expense will vary considerably from month to month depending upon the timing of the various individual projects; thus it is considerably more difficult to allocate specific costs to specific periods. This must be done, however, or the monthly budgets will be badly distorted and will lose much of their effectiveness as a control mechanism. Again, as with the sales budgets, the persons responsible for advertising administration should be thoroughly familiar with the contents of the budget. It is relatively simple to allocate advertising costs to products, if such is necessary. Most advertising programs, which represent the major portion of the expense, are geared to a specific product promotion, and the operating expenses of the department can be prorated to the products in accordance with the distribution of the direct advertising cost. Institutional or company advertising which bears no specific relationship to any product requires different treatment, and is probably best allocated in most cases on the basis of total sales. Circumstances may dictate otherwise though, and the expenses should be considered separately in each case.

The third main category, i.e. administrative expense, presents its own peculiar set of problems. Many of the items are associated with the passage of time, although paid on a quarterly, semi-annual or annual basis, such as property taxes, membership

dues, donations, auditors' fees, etc. In larger companies some expenses such as research and public relations cannot be related to any specific factor like workload, sales volume, number of employees, etc. These companies may make separate units, such as purchasing, engineering, public relations, legal, industrial relations, etc., responsible for these functions. Thus, it is apparent that the budget program for administrative expense must be tailor-made to fit the particular conditions of the organization concerned. One difficult aspect is proper allocation to the various product classifications. Sales volume may measure with reasonable accuracy the proportion of purchasing expense but yet bear no relationship whatsoever to the incidence of engineering or to industrial relations. Investment may be an excellent basis for distributing engineering but completely wrong when applied to legal expenses. The activities of the various units whose operating costs make up the administrative expenses should be carefully reviewed before deciding on the basis of allocation to be used.

Variations in size, organization, business and policies make it impossible to be specific in the approach and technique of budgeting expenses. In fact, even within one organization it is often desirable and even necessary to use different techniques for different units. One of the most common examples is a budget program which combines fixed and variable budgets. Where a unit can forecast its level of operations and hence expense with a high degree of accuracy, a fixed budget, that is one not subject to change during the budget period, may be used. But at the same time, other units, unable to estimate their

levels of activity with the same degree of accuracy, may require a variable budget, i.e. one which takes into account fluctuations in expenses because of variations in the rate of activity. Selling expenses which bear a direct relationship to the rate of business activity are a good example of the latter.

Much more important than mechanics, however, is the philosophy of controlling expenses. In time of prosperity, and especially during the current era, there is an inevitable tendency towards extravagance. In addition, the current high levels of taxation foster such a trend since the final cost of each dollar of expense is greatly minimized by the tax impact. Thus there is an undeniable leaning towards laxity against which management must be vigilant. The unconscious attitude of many people is that with the current level of industrial activity a few dollars more or less will not matter. Unfortunately, in many cases full cognizance and necessary corrective measures are not taken until the degree of laxity has reached considerable proportions. Then, once the situation is recognized, strong measures are required to remedy it. This, in turn, has its drawbacks since the measures taken are often too stringent. Reductions of personnel or selling activity can have ill-effects far more important in the final analysis than is the good produced by any immediate reduction in expenses.

To summarize, control of expenses in the operation of a business depends upon proper management philosophy and judgment. While there are many mechanical aids, no system can accomplish the desired results unaided and good administration and judgment are essential at all times.

## Current Reading

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### EDUCATION

"EDUCATION AND EXPERIENCE FOR C.P.A.'s" (Editorial). *The Journal of Accountancy*, August 1956, pp. 25 and 26.

The report of the Commission on Standards and Experience for Certified Public Accountants, recently published, recommends that there should be five requirements for becoming a certified public accountant:

- 1) college education
- 2) a qualifying examination
- 3) a professional academic program at the postgraduate level
- 4) an internship program as part of the formal education
- 5) the uniform C.P.A. examination

The most controversial feature of the report is the majority view that the experience requirement should ultimately be eliminated. This recommendation is reported to be predicated on the belief that the C.P.A. certificate should be regarded as evidence of qualification to enter the profession, rather than as a mark of demonstrated competence to practice. The dissenters argue, on the other hand, that the C.P.A. certificate should serve as evidence of ability to engage in accounting practice which cannot be attained without practical experience in public accountancy. No doubt the majority of Canadian practitioners concur with this latter opinion.

### ELECTRONICS

"TRAINED PERSONNEL: KEY TO BETTER

DATA PROCESSING" by J. F. Summers, *N.A.C.A. Bulletin*, August 1956, pp. 1443-1449.

This article, by a mathematician who is himself an electronic data processing supervisor in a major oil company, stresses the role played by people in the development of E.D.P. The author sees the rise of a whole new profession with its members drawn from the established fields of accounting, mathematics, statistics and engineering. Such men should not, in his view, be specialists, but should possess experience, training and interests covering a wide variety of fields. There is at present a shortage of people qualified to enter this new profession. Accordingly, Summers cites the need for a comprehensive program of education, training and study on the part of interested groups such as the machine manufacturers, public accounting firms and universities. However, to him, a more important educational job is the creation within an organization of a climate which is conducive to the development of a general data processing program.

He concludes with the following suggested list of fifteen steps to be performed in the work program leading to systems and procedures for machine data processing and computing:

1. Eliminate needless forms and procedures and streamline and simplify the handling of essential forms and procedures in preparation for easier adaptation to automatic machine methods.

2. Standardize procedures with respect to the offices and departments affected.
3. Prepare detailed written charts of accounts in the simplest possible arrangement, for ease of numerical codification, and adopt uniform codes.
4. Determine the most likely areas for improving accounting and mass handling by automatic machine methods.
5. Make a detailed survey study to determine the economic justification of machine applications and the most suitable type of equipment.
6. Define the problems and work to be handled on machines. Consider the overall picture without regard to departmental lines, in order to synthesize, or integrate, data processing to an optimal extent with the objective of taking advantage of all possible uses of a given set of data on a single throughput basis.
7. In the case of large-scale computer programming, consider all of the repetitive routines and make a one-time task of coding these as standard service routines.
8. Commence detailed development of procedures, prepare flow charts, and program the procedures.
9. Design the required forms.
10. Make initial test runs of procedures and correct errors.
11. Set up master files.
12. Complete general machine operating administrative plans to cover scheduling, control and dispatching.
13. Prepare methods and procedures manuals for all applications.
14. Carry to completion the plans and specifications for the physical installation of the equipment.
15. Make final tests on procedures and start production-line operations.

#### FINANCE

"CANADIAN CORPORATE FINANCING" by Frances Oxley, *The Business Quarterly*, Summer 1956, pp. 123-135.

A study of Bank of Canada statis-

tics relating to 704 large Canadian corporations for the years 1947-1953 reveals that they were able to cover all investments in plant, property and equipment, all net working capital requirements and approximately half of all dividend payments with funds obtained from current operations.

About 15.6% of the total funds supplied came from the sale of stocks and bonds, with a relatively smaller proportion coming from stock issues than from long-term debt. As a result, writes Miss Oxley, debt-equity ratios rose for all large corporations during the period studied but to a greater degree for those with assets valued at \$5 to \$25 million than for those with assets over \$25 million.

An average of 45% of all funds available was applied to the expansion of plant, property and equipment, the larger companies, in this instance, investing proportionately more than concerns in the \$5 to \$25 million group. Dividend payments in this same group increased by 48.7% between 1948 and 1953, and represented 31% of the total funds available. Companies with assets of over \$25 million increased their dividends by only 8.8% over the same period, turning over to stockholders only 26.4% of available funds. An actual decline in the total amount of dividend payments made by these companies occurred during 1952 and 1953.

A further study of ten individual companies, seven of which were in the larger of the two groups studied, indicates that the general trends exist to some degree in most of them. But Miss Oxley concludes that there is no precise relationship between asset size and methods of financing and that factors other than size greatly influ-

ence the financial operations and results of corporations.

#### MANAGEMENT

"THE CHANGING CHARACTER OF CAPITALISM" by Theodore Levitt. *Harvard Business Review*, July-August, 1956, pp. 37-47.

"BREAKTHROUGH TO THE FUTURE" by Ralph J. Cordiner. *The Management Review*, August 1956, pp. 671-685.

The editorial in the July 28 issue of *The Accountant* lauds the flexibility and scope and opportunity to exercise professional judgment afforded the public accountant in the audit of American hospitals. Since the passing of the National Health Service Act in 1948, hospital accounts in Great Britain have been audited by men appointed by the Ministry of Health. The editorial notes that these auditors are members of the staff of the Ministry and that few, if any of them, are qualified accountants. Furthermore, the audit of the accounts of all hospitals within the service are reported to be carried out on stereotyped lines to ensure uniformity of procedures.

This distinction between a particular phase of British and American practice brings forcibly to mind the influence of the total social environment on the rights, duties and responsibilities of the independent public accountant, and the need for accountants to see beyond the confines of their own discipline to the broader canvas of the social framework within which business operates.

Dr. Levitt attempts such an appraisal in "The Changing Character of Capitalism". He takes issue with a thesis advanced six years ago by social scientist David Riesman that an

expanding, vigorous capitalist society contains the seeds of its own destruction. Riesman feared that in the United States a nation of individualists, "inner-directed" by their own demands and ambitions, was rapidly becoming a conformist people, "other-directed" by the reactions, standards, and desires of those around them. In *The Lonely Crowd*, Riesman implied that the abundant economy would ultimately result in the atrophy of the capitalist spirit that originally created and maintained it, producing instead a personality devoted to security, acquiescence and routine. Dr. Levitt concedes that the atmosphere of conformity and acquiescence may pose a threat to the vitality of a capitalist economic system, and warns that we may already be farther along the road than we believe: "Mass production, mass communication, mass distribution, mass consumption, and mass bureaucratic work environments are submerging the individual beyond his capacity to resist," he writes. "The result is torpid, devitalized standards of work, of thought, and of ambition". He then proceeds to make a good case for the continued and growing vitality of a capitalist economy, pointing to the glorification of invention, the upsurge of scientific management, human relations, and market research as external forces influencing the modern businessman and tending to create an atmosphere in which capitalism may flourish.

In a different vein, Mr. Cordiner discusses the three areas in business and finance which he believes will present the most urgent challenges to business managers in the next decade: long-range planning; organizing, communicating, and utilizing information for decision-making; and human motivations.



## BOOK REVIEW

**The Administration of Health Insurance in Canada** by Malcolm G. Taylor, Oxford University Press, 1956; p. xiii, 259; \$5.00

In this book, Dr. Malcolm Taylor of the Department of Political Economy at the University of Toronto has outlined the administrative problems of the Canadian health agencies in providing protection from the costs of medical and hospital care. While the professional accountant is always concerned with matters of administration he should also be interested as a probable contributor to or consumer of one of the many services described.

Throughout the text the reader is constantly reminded that an agency for prepaying doctor and hospital bills is the modern means of providing for the financial burden of sickness. It is evident among other things that the newness of the idea has contributed to the establishment of different administrative approaches in the various parts of Canada. Furthermore, there have been many changes and much experimentation. After due consideration, the author calls for extensive research and still more experimentation as the means of finding the ideal protection.

Dr. Taylor emphasizes the problem of the agency maintaining adequate control over the use of the care services and reviews some of the steps taken in this direction. It is apparent that all the other problems attendant upon enrolment, determination of benefits, setting of premiums, and pattern of organization are minor by comparison. In order to avoid abuse of the services it appears inevitable that elaborate precautions are required.

The various Canadian health agencies are described in the text as contract practice, municipal doctor system, commercial insurance, Blue Cross hospital care plans, profession-sponsored medical care plans, government-sponsored hospital care plans, Swift Current medical care plan, public medical care plans and industry-sponsored plans. This classification is according to the motives of the sponsors of the agency involved. They are commonly referred to as government, voluntary, or commercial depending upon their form of administrative control rather than on the motives for their establishment.

While Dr. Taylor suggests in the preface that no conclusions can be drawn as to the desirability of government over voluntary agencies, it is apparent that he favours government agencies on the grounds that the government can give wider protection with a lower administrative cost. This appears to be very doubtful as so much of the government cost may be hidden.

On page 52 it is reported that only the Province of Quebec has a legislative regulation requiring a deposit from Blue Cross plans. However, the Province of New Brunswick has required a deposit of \$20,000 from the Maritime Blue Cross plan.

Relative to the problem of control on page 201, the reference to the installation of standardized cost accounting is not technically accurate. As the author has pointed out elsewhere, the Canadian Hospital Association has advocated national uniform general accounting. This type of accounting will permit the use of cost analysis.

While the text is a comprehensive summary of the various types of ad-



ministration for health insurance in Canada, it is unfortunate that there is no discussion of the costs of the ideal universal protection plan proposed. Such a projected health scheme can function only under a tax program at all levels of government. While it may only be a transfer payment, it is a tax and tax is a burden. This is particularly so when it is authoritatively stated that current taxes in relation to income have reached an all-time high.

Relatively free of statistics and with a good index, Dr. Taylor's book is highly readable and should prove of interest to accountants, particularly those associated with health services.

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## SELECTED READING

### Accounting:

"Production and Inventory Controls in Apparel Manufacturing" by Klein & Goldberg, *N.Y.C.P.A.* Aug. 1956, pp. 474-479.

"Direct Costing — Its Nature and Significance" by E. H. Jones. *The Chartered Accountant in Australia*, April 1956, pp. 547-577.

### Auditing:

"The Use of Paid Cheques as Evidence of Payment in Audit Procedure" by Cavaye & others. *The Chartered Accountant in Australia*, January 1956, pp. 371-377.

"Developments in New Zealand Auditing Practice" by C. H. Perkins. *The Accountants' Journal*, April 1956, pp. 325-329.

### Finance:

"Installment Credit: the \$28 Billion Question" by S. E. Rolfe. *Harvard Business Review*, July-Aug. 1956, pp. 48-60.

"The Big Corporate Lenders" (sixth in a series on "Financing") by C. E. Silberman. *Fortune*, Aug. 1956, p. 111 et seq.

### Management:

"Communications as a way of Industrial

Life" by L. Teplow. *The Management Review*, Aug. 1956, pp. 702-708.

"Controllershship and Cost Accounting" by J. L. Peirce. *Controller*, Aug. 1956, p. 359 et seq.

"The Guaranteed Annual Wage" by H. C. Pentland. *Cost and Management*, May 1956, pp. 190-197.

### Professional:

"Installation of Management Accounting in a Small Business" by H. Hodgson. *The Accountant*, July 28 & Aug. 3, 1956, pp. 76-79.

"Management Advisory Services in the Field of Accounting" by Paul Grady. *Controller*, Aug. 1956, p. 370 et seq.

"Pensions for Practising Accountants" by T. A. E. Layborn, *Accountancy*, June 1956, pp. 212-214.

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*Accountancy* (Eng.), Incorporated Accountants' Hall, Temple Place, Victoria Embankment, London, E.C. 2.

(*The*) *Accountant* (England), 4 Drapers' Gdns., Throgmorton Ave., London, E.C. 2.

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*Business Quarterly*, School of Business Administration, University of Western Ontario, London, Canada.

(*The*) *Chartered Accountant in Australia*, c/o The Institute of Chartered Accountants in Australia; Box 3921, G.P.O., Sydney, N.S.W.

(*The*) *Controller*, 2 Park Ave., New York 16, N.Y.

*Fortune*, 9 Rockefeller Plaza, New York 20, N.Y.

*Harvard Business Review*, Gallatin House, Soldiers Field, Boston 63, Mass.

*Journal of Accountancy*, 270 Madison Ave., New York 16, N.Y.

N.A.C.A. *Bulletin*, 505 Park Ave., New York 22, N.Y.

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Oxford University Press, 480 University Ave., Toronto 2, Ont.

# The Tax Review

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## TAX APPEALS

It is a basic principle of the common law that the subject is not to be taxed without the authority of Parliament clearly expressed to that end. From this it follows, as the English Courts have said many times, that if the person sought to be taxed comes within the letter of the law he must be taxed regardless of the Court's opinion as to the justice of the case but, on the other hand, if the Crown cannot bring the subject within the letter of the law then no tax can be exacted from him however apparently within the spirit of the law the case might otherwise be. This last statement is the foundation of the law of taxation in common law countries.

This rule, the fundamental rule of tax law, would seem to place the primary burden on the Crown, and this would be so if it were not for another rule of law, a rule not of the ancient common law, but a judge-made rule of fairly recent innovation which stems from an interpretation of the taxing statute. This rule, which is laid down most clearly in the Supreme Court case of *Johnston v. MNR* [1948] S.C.R. 486 accords to the Crown the right to resolve all questions of fact in its favour by virtue of making an assessment to tax, subject to the right of the taxpayer to establish the true facts by evidence. There is thus a contradiction between the old common law principle and the more recent judge-made rule as to

onus of proof, a contradiction which was clearly seen by the late Chief Justice of Canada, Sir Lyman P. Duff, in the famous case of *Anderson Logging Co. v. The King*, decided in 1924. Sir Lyman in that case indicated that the theoretical perfection of the ancient principle had to be reconciled with the practical necessities of tax administration in a modern world, and that the conflict between the two rules could be settled by the application of common sense without rejecting either of them.

Perhaps the only thing further to say concerning this aspect of tax law is that the Courts are still working towards a solution of this vital question. See, for example, the recent decision of the Supreme Court in *Miron & Freres v. MNR*, where a division of opinion is clearly shown. In that case a man bought a quarry for \$90,000 and shortly afterwards sold it for \$600,000 to a company of which he and his five brothers owned all the shares. The Minister ruled that the vendor and the purchaser were not at arms length and that the purchaser could only claim capital cost allowances on a deemed cost of \$90,000 for the quarry. There were appeals by the company to the ITAB, the Exchequer Court of Canada and to the Supreme Court of Canada, where the facts relied on were those set out above. That is to say, the appellant company gave no additional facts as e.g. to establish that the six brothers did in

fact deal with one another at arms length. The company was unsuccessful in all its appeals, but in the Supreme Court the five Judges did not agree on their reasons for rejecting the appeal. Chief Justice Kerwin and Mr. Justice Fauteux held that the facts before the Court showed of themselves that the transaction was not at arms length, but the other three Judges, Taschereau, Kellock and Abbott JJ. held that the Minister's assessment postulated a finding that the transaction was not at arms length, and this was conclusive on the Courts unless the taxpayer furnished evidence which satisfied the Court that the Minister erred.

One can only say that if the view of the majority is carried as far as it is possible to carry it the old common law principle will soon be shattered into fragments.

#### **When an Appeal Lies**

An appeal lies only from an assessment by the Minister, and, it has recently been determined by the Supreme Court of Canada, an assessment is an amount of money fixed by the Minister as the tax due by the taxpayer. That is to say, there is no right of appeal if the Minister issues what is commonly called a "nil" assessment, i.e., a notice on the usual assessment form but claiming no tax. Thus a recent case involving a question of considerable importance was appealed through the ITAB and the Exchequer Court to the Supreme Court where it was quashed on the ground that it should never have been brought at all since the taxpayer had not been assessed to tax for the year in respect of which he appealed.

On the other hand, if a tax of even as little as \$1.00 is claimed by the Minister then an appeal will lie. The

question has arisen, and will doubtless arise again, whether an appeal will lie from an assessment for less tax than the taxpayer desires to pay, as e.g., where the assessment is for \$10,000 and the taxpayer contends that he is liable for \$20,000. One can hardly say in such a case that the taxpayer has been aggrieved; yet, as mentioned above, there have been tax appeals of this character. The statute would appear to confer a right of appeal in such a case. Thus, s. 58 merely states that "a taxpayer who objects to an assessment may . . . serve on the Minister a notice of objection . . ." and secs. 59 and 60(2) provide for appeals to the ITAB or to the Exchequer Court where a taxpayer has served notice of objection to an assessment under s. 58. Clearly, if an appeal will lie where the taxpayer claims he is liable for more tax than he is assessed providing he is assessed for some tax, an anomalous situation is created by the decision of the Supreme Court holding that no appeal lies from a "nil" assessment, and this is perhaps a situation calling for corrective action by the Legislature.

#### **Appeals for Loss Years**

The Act permits a business loss sustained in a taxation year to be carried back to the previous year if the previous year was a profit year, and it also (s. 46(5)) provides for a reassessment of the tax for the previous year. If there were no reassessment in such a case the taxpayer would be deprived of his statutory right to deduct the second year's loss from the former year's profit.

#### **The Tax Tribunals**

There are two courts with original jurisdiction to hear tax appeals, the Exchequer Court of Canada and the

Income Tax Appeal Board, and the former also has jurisdiction to entertain appeals from the latter. The Exchequer Court, composed of a President and five puisne Judges, all appointed for life (i.e. until attaining the age of 75) is a superior Court possessing all the inherent jurisdiction of Her Majesty's superior courts of common law and equity. The ITAB, on the other hand, is an inferior tribunal, with Judges appointed for a ten year term, and as a pure creation of statute its jurisdiction must be found entirely within the language of the statute. That is, it possesses no inherent jurisdiction.

A taxpayer who desires to appeal from an assessment has his choice of tribunals. He may appeal to the Income Tax Appeal Board or, if he prefers, he may appeal to the Exchequer Court of Canada. If he chooses the former he has a further right to appeal from its decision, should it be against him, to the Exchequer Court, and the Minister likewise has a right to appeal from an adverse decision of the ITAB to the Exchequer Court.

The cost of an appeal to the Income Tax Appeal Board cannot exceed \$15 and, if the appeal is successful, the cost will be nil. The taxpayer is never chargeable for the Crown's costs even though the appeal fails. The costs of an appeal to the Exchequer Court, however, will usually be substantial, and if the taxpayer fails in his appeal the Crown is entitled to its costs as taxed by the Court.

It is quite clear now, though this was not understood in the early days of the Income Tax Appeal Board, that the institution of the latter tribunal for the hearing of appeals of taxpayers was designed, one may perhaps

say, as a pressure escape valve. With the great increase in rates and incidence of income taxation, the utterance of complaints during the war years became louder and longer, and the then existing appeal procedure, both in the matter of expense and accessibility of the Court, left much to be desired. Hence the new Income Tax Appeal Board with its four specialized tax judges who make their circuit of the whole Dominion two or three times each year.

The ITAB is perhaps the busiest Court in the whole of Canada, excluding the police courts, and one cannot but marvel at the energy and devotion of the Chairman, Assistant Chairman and the members. No branch of the law covers a broader and more complicated segment of the life of humanity than does the law of income tax. The law as a whole is in a sense an abstraction of society, representing the myriad threads which bind individuals to one another and to society as a whole in innumerable relations. For each of these relations there are appropriate legal rules and principles, such as those concerning domestic relations, parent and child, husband and wife, those concerning the rights of property, real and personal, those concerning inheritance, wills, executors, trustees, etc. etc. In this country further complications are added by the distribution of legislative powers between Provinces and the Dominion as well as by the parallel existence of the civil law of Quebec derived from the old Roman Law by way of Napoleon's Code and of the common law of the nine English-speaking Provinces derived from the law of England. All of this vast complicated structure falls within the purview of the Income Tax Appeal Board, which would be difficult

enough if it were not multiplied by the large number of cases which must be heard by that Board each year.

When should one appeal to the ITAB and when to the Exchequer Court? This is a question to which a clear answer cannot be given, as it is largely a matter of opinion. Where the dispute involves a large amount and the taxpayer is prepared to take the matter to the Supreme Court of Canada if need be, an appeal to the ITAB may be thought unnecessary.

On the other hand, an appeal to that tribunal will at least oblige the Crown to disclose its case and permit the issues to be winnowed. That may be regarded as a tactical advantage which outweighs the expense of preparing and presenting the appeal and the risk of an adverse decision, which is a psychological disadvantage since judges, disliking the reversal of their own judgments by higher Courts, are not apt to be predisposed against the judgments of lower judges.

#### ANNUAL CONFERENCE

*Continued from page 336*

incoming president, W. Givens Smith of Regina, who spoke briefly of the increasing demands on the profession. The president presented Mr. Martin with a gift of flash photographic equipment as a mark of appreciation for his work on behalf of the membership during his term of office. Fraternal greetings were expressed by the presidents the Institute of Chartered Accountants of Scotland and the American Institute of Accountants.

Earlier in the evening the Governor General's Chartered Accountancy Gold Medal was presented by the Lieutenant Governor to John E. Sands of Toronto for the candidate obtaining the highest marks in Canada in the uniform final examinations. The names of the three winners of the article writing competition, sponsored by *The Canadian Chartered Accountant*, were also announced. Details appear elsewhere in this issue.

Of course, the social side of any convention is important. On Monday the ladies were taken on a 30-mile circular drive to the home of

Mr. and Mrs. R. A. Finley at Waverley, and on Tuesday they enjoyed a "Brunch" party at the home of Mr. and Mrs. Gerald Martin at Jollimore Village. On Tuesday afternoon seven busloads of members and their ladies visited Peggy's Cove, Nova Scotia's well known and picturesque fishing village. This was followed by a truly Maritime highlight, an open air lobster boil at the south shore community of Hubbards. As darkness came on the party adjourned to the Shore Club for square dancing. On Wednesday, September 12, a morning reception was held for the ladies at Government House. This was followed by a luncheon at the Lord Nelson Hotel. The closing dinner and dance on Wednesday evening at the Nova Scotian Hotel brought the 54th annual conference to a close. Membership in North America's oldest social club, Nova Scotia's "Order of the Good Time", requires seven days residence in the Province. Members attending the Conference packed so much interest and enjoyment into their 3-day stay that they may well feel that they became members, figuratively, if not in fact. Another successful conference has been achieved.

# *Students Department*

*Associate Professor,  
Queen's University*

## NOTES AND COMMENTS

Sometimes our morning mail arrives before we leave for the office, and the welcome though infrequent receipt of a dividend cheque at this time sends us on our way with a degree of compatibility which lasts well into the morning.

The other morning, however, our admiration for a dividend cheque for \$1.50 thus received was tempered somewhat by the observation that neither of the signing authorities had actually signed the cheque in person. Their signatures had obviously been imprinted by a stamping device. Could it be, we thought, that the small shareholder is not as important to company officials as they are wont to say at company meetings? Besides, did the company take no pride in its dividends? But upon further consideration we decided that probably the larger dividend cheques would have been signed in the same way, too; and that possibly (time would tell) the company officials could employ their time more usefully in the shareholders interest than by signing the dividend cheques personally.

As we reflected upon this system of signing, it seemed to have some of the characteristics of a signature by seal. Why, after all, did not the company use its seal on its cheques instead of these facsimile signatures? (Section 5 of the Bills of Exchange Act specifically permits a company to sign negotiable instruments with its

seal.) Perhaps the answer was that the by-laws of the company required (as the by-laws of many companies do) that the corporate seal can be affixed only in the presence of certain highly placed company officials.

We recalled having read that long ago, when not many people could read and write, the seal was a convenient device for avoiding the embarrassment of admitting one's illiteracy. People wore signet rings and could attach their signatures in a flash to any document within arm's length by impressing the design of the ring into the paper. But in more recent times the ink manufacturers, the fountain and ball pen people, and now apparently the fellows who manufacture these signature stamping machines, have done a splendid job of persuading us that it is more convenient to sign by devices which they supply. That the resulting signature is frequently less recognizable than a distinctive coat of arms or other design is, of course, another matter.

The seal has a positive use in the law of contract as an answer to a lack of consideration, as a means of conferring extensive authority upon an agent in a power of attorney, of extending the time which may elapse before the contract will be statute barred, and of satisfying statutory requirements in the execution of long term leases, mortgages, and deeds of land.



Companies seem in general to be rather inhibited in the use of their seal; it is something reserved for certain sacred moments in the history of the company. One pictures the corporate seal being brought out of the vault solemnly by its custodian on those mysterious and impressive occasions when many lawyers and company officers are present. And doubtless this is as it should be. In our mind's eye we can picture fresh auditing problems if the use of the seal were to get out of control!

In *Handbook on Canadian Company Law* (fourth edition, page 188), Fraser states: "The [corporate] seal is impressed on share certificates in jurisdictions where this requirement is

imposed, bonds, debentures, debenture stock certificates, trust deeds, contracts, mortgages, copies of documents certified by an officer of the company and other important documents. The by-laws or articles will designate the officers who will sign documents under the corporate seal or in whose presence the seal will be affixed. Usually these officers will be the president or vice-president and the secretary or treasurer. If the articles contain special provisions, e.g., that the seal must be affixed by specified officers, a person dealing with the company must see that the document apparently conforms to such provisions. . . ."

### THE QUESTION CORNER

If asset accounts such as finished goods or work-in-process inventories are presented on the balance sheet "as estimated and determined by responsible officials of the company", or some such wording, does that under present Canadian practice

imply that the auditor has satisfied himself by "other auditing procedures" that the amount shown is at least substantially correct, and if he has not, must he so state?

—H. G., Calgary.

### Editor's Reply

This problem is discussed in Bulletin No. 7 of the Canadian Institute of Chartered Accountants. That bulletin emphasizes that the financial statements are those of the directors of the company, and that a note to the effect that the inventories are "as determined and certified by the management" must be construed as part of the financial statements presented by the directors. The auditor's duty is to report upon the financial statements as prepared, and accordingly a reference of this kind does not relieve the auditor of responsibility.

In the same bulletin, the Com-

mittee on Accounting and Auditing Research of the C.I.C.A. expresses the opinion that generally accepted auditing procedure in Canada in respect of inventories includes:

- (1) a review of the methods followed in the determination of quantities and values;
- (2) the testing of the inventory quantities with confirmatory evidence such as rough count sheets and perpetual stock records; and
- (3) the testing of the pricing of the inventory and its clerical accuracy.

The test must be sufficient in scope



to satisfy the auditor that the stated basis is being followed and to determine whether the basis is consistent with that of the previous year.

If the conditions outlined by the committee and described above are not satisfied, it follows that the auditor should qualify his report. If

one wants to know whether the auditor is satisfied about the financial information included in the company's statements, he should therefore look at the auditor's report and not at the description of the various items themselves as they appear in the statements.

*(Comments and criticisms of the editor's reply are invited)*

### PUZZLE

A professor of economics, travelling from London to Birmingham in a train going at 40 miles per hour, pulled the communication cord just after a train from Birmingham to London, going at 50 miles per hour, had passed his train in  $3\frac{1}{2}$  seconds. The reason

he gave for doing so was that he wished to know the length of the train in which he was travelling. It cost him £5 to learn that the answer to his query was 84 yards. Just as a matter of curiosity, what was the length of the other train?

(Submitted by Mr. S. B. Bentley, C.P.A., Ottawa)

*The solution to this puzzle appears after the Problems and Solutions, at the end of this month's Students Department.*

### PROBLEM 1

*Primary Examination, October 1955 (Ontario)*

#### Accounting I, Question 1 (15 marks)

On January 1, 1954, John Doe opened a shoe store under the name of "Doe's Shoe Store" and deposited \$25,000.00 in the bank account. For the year ended December 31, 1954, Doe's disbursements are summarized as follows:

(a) fixtures .....	\$ 8,000.00
(b) merchandise purchased for sale .....	79,342.00
(c) expenses:	
rent .....	6,600.00
salaries & wages .....	8,341.00
advertising .....	638.00
insurance .....	468.00
delivery .....	693.00
general & office .....	348.00
(d) withdrawals for personal use .....	6,000.00

As at December 31, 1954, the following additional information is available:

- (a) the accounts receivable amount to \$1,098.00 of which \$110.00 appears doubtful.
- (b) cash on hand and in bank totals \$631.00.
- (c) the accounts payable consist of \$8,432.00 owing to suppliers for merchandise purchased for sale and \$59.00 owing to a local newspaper for an advertisement.
- (d) the lease calls for a monthly rental of \$600.00.
- (e) insurance was paid for a three year term and expires March 31, 1957.
- (f) merchandise inventory amounts to \$25,350.00.
- (g) depreciation is to be provided on the fixtures at an annual rate of 10%.

**Required:**

From the above information, prepare a statement of profit and loss for the year ended December 31, 1954 and a balance sheet as at that date.

**A SOLUTION**  
**DOE'S SHOE STORE**

**STATEMENT OF PROFITS AND LOSS**  
**for the year ended 31 Dec. 1954**

Sales revenue .....		\$87,159.00
Deduct cost of goods sold:		
Purchases .....	\$87,774.00	
Less inventory, 31 Dec 1954 .....	25,350.00	
		62,424.00
Gross trading margin .....		24,735.00
Deduct selling and administrative expenses:		
Rent .....	7,200.00	
Salaries and wages .....	8,341.00	
Advertising .....	697.00	
Insurance .....	117.00	
Delivery expense .....	693.00	
General and office expense .....	348.00	
Depreciation of fixtures .....	800.00	
Bad debts .....	110.00	
		18,306.00
Profit for the year .....		\$ 6,429.00

**DOE'S SHOE STORE**  
**BALANCE SHEET AS AT 31 DEC 1954**  
**ASSETS**

**Current assets**

Cash on hand and in bank .....	\$ 631.00	
Accounts receivable .....	\$1,098.00	
Less allowance for doubtful accounts .....	110.00	
	<hr/>	
	988.00	
Merchandise inventory, at cost .....	25,350.00	
Prepaid insurance, at cost .....	351.00	
	<hr/>	
Total current assets .....		\$27,320.00

**Fixed assets**

Fixtures, at cost .....	8,000.00	
Less accumulated depreciation .....	800.00	
	<hr/>	
Total fixed assets .....		7,200.00
		<hr/>
		\$34,520.00
		<hr/>

**LIABILITIES AND CAPITAL****Current liabilities**

Accounts payable .....	\$ 8,491.00	
Accrued rent .....	600.00	
	<hr/>	
Total current liabilities .....		\$ 9,091.00

**John Doe Capital**

Investment, 1 Jan 1954 .....	25,000.00	
Add profit for the year .....	6,429.00	
	<hr/>	
	31,429.00	
Deduct drawings for the year .....	6,000.00	
	<hr/>	
Balance, 31 Dec 1954 .....		25,429.00
		<hr/>
		\$34,520.00
		<hr/>

**PROBLEM 2**

*Intermediate Examination, October 1955*

**Accounting I, Question 7 (20 marks)**

CA is the auditor of Y Co. Ltd. In the course of his examination of the accounting records for the year ending 31st Dec 1954, he finds that the balance of Dr. \$435,005 in an account captioned "Real Estate" is made up as follows:

**Debits**

Cost of land and old buildings .....	\$250,000	
Cost of demolishing old buildings .....	7,500	
Excavation .....	5,900	
Architects fees .....	10,000	
Contractors progress billings .....	200,000	
Interest on bonds issued to obtain funds for construction .....	12,000	
Payments to tenants of old buildings to induce them to vacate .....	5,000	
Hydro bill during period of construction .....	300	
Insurance premiums .....	1,200	\$491,900

**Credits**

Proceeds of salvage from old building .....	\$ 4,000	
Holdbacks from contractors billings .....	30,000	34,000
		<hr/>
		\$457,900
Depreciation at 5% .....		22,895
		<hr/>
		\$435,005

The following information is obtained:

- (i) The company had purchased the land and old buildings to provide a site for their new factory building.
- (ii) Construction of the new factory building began 1st Jan 1954. The building was completed and occupied on 30th June 1954.
- (iii) 6% bonds of a par value of \$200,000 were issued on 1st January to provide funds for construction of the new factory building.
- (iv) In addition to progress billings recorded, a final billing of \$15,000 was received in November 1954 but was not set up in the company records. This amount together with holdbacks becomes due on 15th February 1955.
- (v) Insurance premiums included in the account were for a 3 year fire insurance policy on the building, expiring 31st Dec 1956.
- (vi) The company's policy is to charge depreciation on buildings at 5% per annum from date of acquisition to date of disposal.

**Required:**

Journal entries, complete with narratives, to adjust the company's records as at 31st Dec 1954.

**A SOLUTION**  
**Y CO. LTD.**  
**GENERAL JOURNAL**

1954		Dr.	Cr.
31st Dec	Land .....	250,000	
	Real estate .....		250,000
	To charge cost of land and old buildings to proper asset account .....		

31st Dec	Land .....	3,500	
	Real estate .....		3,500
	To charge cost of demolishing old buildings less proceeds of salvage to Land account		
31st Dec	Building .....	15,900	
	Real Estate .....		15,900
	To charge cost of excavation and architect fees to Building account		
31st Dec	Building .....	170,000	
	Real estate .....		170,000
	To charge net amount of payments to contractors to Building account		
31st Dec	Bond interest expense .....	6,000	
	Building .....	6,000	
	Real estate .....		12,000
	To charge bond interest during construction period to Building account and the remainder to bond interest expense		
31st Dec	Building .....	45,000	
	Accounts payable .....		45,000
	To charge to Building amounts owing to contractor as follows:		
	Holdback .....	\$30,000	
	Final Billing .....	15,000	
		<u>\$45,000</u>	
31st Dec	Land .....	5,000	
	Real estate .....		5,000
	To charge payments made to tenants of old building to induce them to vacate to cost of land		
31st Dec	Building .....	200	
	Insurance expense .....	200	
	Prepaid insurance .....	800	
	Real estate .....		1,200
	To reclassify 3 year fire insurance premium charged to real estate. Calculated as follows:		
	Charged to building - 6 months' premiums		
	" " insurance - 6 months' premiums		
	" " prepaid insurance 24 months' premiums		
31st Dec	Building .....	300	
	Real estate .....		300
	To charge hydro bills during period of construction to Building account		

31st Dec	Real estate .....	22,895	
	Accumulated depreciation — building .....		5,935
	Depreciation .....		16,960
	To clear real estate account and to adjust depreciation to 5% from 1st July to 31st Dec on balance in Building account (\$237,400)		

### *Examiner's Comments*

In the examiner's opinion the question was a relatively easy one, and the standard of the candidates' answers was good. A few did not present their solution in the form of journal entries as required by the question. Those who submitted the poorest answers failed to realize that "Real Estate" should be analyzed between land account and building account.

### PROBLEM 3

*Final Examination, October 1955*

**Auditing II, Question 1 (15 marks)**

CA has been the auditor of an investment trust for several years. Its assets and liabilities consist only of cash, shares and bonds, income receivable or accrued, and amounts receivable and payable for sales and purchases of investments. The securities are held by a chartered bank for safekeeping. The trust has a satisfactory system of internal control.

#### **Required:**

- (9 marks) (a) State briefly what audit procedures CA should carry out in his examination of investment transactions for the year 1954, the item "investments" appearing in the balance sheet as at 31st Dec 1954 and the item "income from and profits on investments" included in the statement of profit and loss for the year ended 31st Dec 1954.
- (6 marks) (b) Draw up the working paper or papers, setting out thereon the appropriate headings, which CA should prepare for inclusion in his working paper files with respect to the investments and related items.

### A SOLUTION

- (a) **A INVESTMENT TRUST CO.**  
**AUDIT PROCEDURES**

#### **Investments**

1. Check opening balances of investments from previous year's working papers.
2. Vouch purchases and sales of securities by examining brokers' advices and check these transactions to the investment ledger. Check computations of cost of investments sold and related profit or loss.
3. Add the investment ledger, take off a trial balance, and agree total with control account.

4. Confirm with the chartered bank the securities held by it on behalf of the trust.
5. Confirm with brokers the investments purchased but not received, and sold but not delivered.
6. Ascertain that all changes in investments are within the power of the company and have been approved by the Board of Directors or others designated by the Board.
7. Check the closing market values by referring to published quotations and brokers.

#### Income from and profits on investments

1. On the basis of the transactions recorded in the investment ledger compute the actual interest earned and dividend income for each security held during the year. Calculate the dividends from an independent published dividend record.
2. Compute interest accrued and dividends receivable on investments held at year end.
3. Verify that cash receipts less amounts receivable at previous year end (per working papers of previous audit) plus amounts receivable or accrued at current year end equal the investment income computed in step 1.
4. Check the postings in the profit on sale of investment accounts to the vouched sales entries.
5. See that disclosure of investment transactions in the financial statements is adequate.

(b)

#### A INVESTMENT TRUST CO.

AUDIT WORKING PAPERS — YEAR ENDED 31 DEC 1954

#### Analysis of Investments

	Common shares in X Co. Ltd.		5% Mortgage Bonds in Y Co. Ltd. due 15 Mar 1963 par value \$100		etc.
	no. of shs.	Amount			
Balance 31 Dec 1953					
(cost) .....	---	\$xxx		\$xxx	
Add purchases during year					
(cost) .....	---	xxx		xxx	
	---	xxx		xxx	
Deduct sales during year					
(selling price) .....	---	xxx		xxx	
	---	xxx		xxx	
Add back profit on sales		xxx		xxx	
Deduct loss on sales		---		---	
Balance 31 Dec 1954					
(cost) .....	---	\$xxx		\$xxx	
Location of investment		---		---	
Market value 31 Dec 1954		\$xxx		\$xxx	
Minutes authorizing purchases and sales checked					



A INVESTMENT TRUST CO.  
AUDIT WORKING PAPERS — YEAR ENDED 31 DEC 1954

**Analysis of Investment Income**

	<i>Common shares in X Co. Ltd.</i>	<i>5% Mortgage Bonds in Y Co. Ltd. Int. 15 Mar. &amp; 15 Sep.</i>	<i>etc.</i>	<i>Total</i>
Cash received during year				
Dividends .....	\$xxx			\$xxx
Coupons .....		\$xxx		xxx
Accrued interest received on sale .....		xxx		xxx
	xxx	xxx		xxx
Deduct dividends and accrued interest receivable 31 Dec 1953 ....	xxx	xxx		xxx
	xxx	xxx		xxx
Add dividends and accrued interest receivable 31 Dec 1954 ....	xxx	xxx		xxx
	xxx	xxx		xxx
Deduct accrued interest purchased .....		xxx		xxx
Investment income for year .....	\$xxx	\$xxx		\$xxx

*Examiner's Comments*

The examiner reports that some candidates confused an investment trust with a trust company or a stock brokerage business. He notes that many of the answers to part (b) demonstrated a serious weakness in the preparation of working papers.

**SOLUTION TO PUZZLE**

The trains travel a distance equal to their combined length in  $3\frac{1}{2}$  seconds, at 90 m.p.h. Number of yards travelled at 90 m.p.h. in  $3\frac{1}{2}$  seconds:

$$\frac{90 \times 1,760 \times 3.5}{3,600}$$

Let the length of the other train be "X" yards.

$$\text{Then, } 64 + X = \frac{90 \times 1,760 \times 3.5}{3,600}$$

$$\text{and } X = 70$$

The length of the other train was 70 yards.

# Canadian Tax Foundation

## **Eighth Report to the Sponsoring Associations**

Submitted on behalf of the Board of Governors of the Canadian Tax Foundation to the Taxation Section of the Canadian Bar Association and to the Council of The Canadian Institute of Chartered Accountants at their respective annual meetings in 1956.

WE TRANSMIT herewith for your information the tenth annual report of the Canadian Tax Foundation for the year ended December 31, 1955, as presented and approved at the last annual general meeting held in Toronto on March 22, 1956. A copy of this report, which covers the financial position for the last fiscal year and contains statements by officers of the Foundation on every aspect of its work, has already been forwarded to all members of the Foundation. The present statement therefore is mainly intended to supplement the annual report with more recent information.

### **Membership and Finance**

During 1955 there was a net addition of 33 new corporate subscribers and about 100 new individual members. In the first six months of the current year another 23 corporations and 88 individuals have become members. In addition several of the existing corporate subscribers have increased their annual contributions. The governors and other supporters throughout Canada are now directing their efforts toward reaching the new budget objective of \$150,000 announced at the 1956 annual meeting, and as a result of their activities there

will be further new members in the balance of the year.

### **Tax Legislation**

On Wednesday, June 18, within a few days of first reading, a committee of lawyers and accountants met in Ottawa under Foundation sponsorship to review the 1956 Income Tax Act amending bill. Representations were made to the Minister of Finance following this review. In the following week, as a new venture, public meetings for our members were held in Toronto and Montreal to discuss the provisions of the legislation. This innovation was warmly received by our members, and similar meetings will be held annually henceforth.

The Foundation has set up committees in several cities to review the new death tax legislation as soon as it is submitted to Parliament. The findings of these committees will be made the basis of subsequent representations to the Minister of Finance.

No announcement had been made by the government at the time of preparing this report of the action it proposes to take on implementing the main proposals of the report of the Sales Tax Committee. When such proposals are announced the Founda-

tion will review them and if necessary make representations.

### Publications

No major new studies have been issued in the three months since the annual meeting was held. The annual review of the federal revenues and expenditures — the National Finances — has been completely revised and early in July was in the hands of the printer. The statistician has in the final stages of preparation material for a handbook of government financial statistics which it is hoped can be printed and issued later this year. It is also anticipated that the manuscript of a study of the financial implications of health insurance will be sent to the printers during the summer.

*The Canadian Tax Journal* and the *Tax Memo*, which serve as vehicles for writing on a variety of tax subjects and as outlets for a good deal of the staff's research work, are now well recognized and highly regarded in both Canadian and international circles.

### Research Program

The study of forestry taxation begun early in 1955 is now reaching completion, and the final report, which will be a unique document in Canadian tax annals, will probably be issued before the end of the year. On its completion the staff will turn its main attention to a study of petroleum taxation, which will be equally important in scope and character.

During the summer a survey is being made by questionnaire of the various methods used by business firms in handling the administration of their tax payments. The results of this survey will be published and will pro-

vide material for discussion at the annual conference.

The director has the research program constantly under review and developments for other studies and projects have not reached sufficient finality as yet to be announced.

### Annual Conference

The annual tax conference will meet this fall at the Windsor Hotel in Montreal on November 12 and 13. The program committee is under the chairmanship of Willard Hamilton, Montreal, a vice-chairman of the Foundation, and subjects for discussion will include the new death tax legislation, if available, the report of the Sales Tax Committee and several aspects of income tax, including taxation and foreign investment, capital gains taxation, inventory valuation, the tax implications of the statutory merger, tax administration from the viewpoint of the taxpayer and government, federal-provincial tax arrangements and tax treatment of the self-employed saver. Further details will be announced later.

### New Quarters

During the summer the Foundation office was moved from 191 College Street, where it has been for approximately 3½ years, to 154 University Avenue. The new quarters will be much more convenient for both Toronto and out-of-town visitors, since they are close to both the downtown area and the large hotels. They will also give the existing staff much improved working conditions and allow room for the expansion of staff projected in the 1955 annual report. Considerable expense has been incurred in furnishing the new quarters in order to make them attractive and in

keeping with the position of the Foundation.

### **Director's Activities**

The director has addressed several organizations in Canada and the United States during the spring and summer and plans on visiting most parts of Canada in the present year. He also assisted in planning an income tax seminar for businessmen at Queen's University in August, and will participate in the seminar's program.

The only recent staff change has been the engagement of R. A. Rawkins as librarian on the resignation of Mrs. Maxine Chrysler.

### **M. L. Gordon Fellowship**

The M. L. Gordon Fellowship for 1956 was awarded for a second year to Mr. C. Frank Owen to enable him to complete a study of the effects of taxation on corporate finance.

### **Professional Support**

The enthusiastic support of the members of the sponsoring professions has been the secret of the solid

success achieved by the Foundation in its first ten years. Under their guidance and with their support the Foundation has become a well-established institution with a national reputation. As the last annual report indicated completion of the first decade marked the accomplishment of the goal of a budget of \$120,000 set some years ago. For the future an expanded program involving an annual budget of \$150,000 has been set as a new objective. The recent move to new offices completes one important phase of this program. The other phases will involve the addition of two or three new staff members and the inauguration of new activities. In the achievement of these goals we are confident that the Foundation will continue to enjoy the full support of the sponsoring professions.

Respectfully submitted on behalf of the Board,

M. GERALD TEED,  
*Chairman*

HENRY F. WHITE  
*Vice-Chairman*

A. WILLARD HAMILTON  
*Vice-Chairman*

### **MAJOR-GENERAL J. G. ROSS**

A motion was passed at the recent annual conference of the Canadian Institute of Chartered Accountants to send greetings to Major-General J. G. Ross of Montreal, dean of the profession, in his 73rd year as a member of the Institute of Chartered Accountants of Quebec. Regrettably, Major-General Ross, who was in his 95th year and in failing health, died within a few hours of the members' expression of these sentiments. An obituary will appear in a future issue.

## NEWS OF OUR MEMBERS

### *Alberta*

Macintosh, Ross & Co., Chartered Accountants, announce the removal of their offices to The Lamont Bldg., 411 Sixth Ave. S.W., Calgary.

B. C. Tanner, C.A. has been awarded the Sloan Fellowship by the Massachusetts Institute of Technology. This award was made available to Canadians for the first time this year.

Ronald I. Smith, C.A. announces the opening of an office for the practice of his profession at 109 Petroleum Bldg., Edmonton.

### *British Columbia*

Rickard, Crawford & Co., Chartered Accountants, and Paul H. Sprinkling, C.A. announce the amalgamation of their practices. The combined practice will be carried on under the firm name of Rickard, Crawford & Co., Chartered Accountants, with offices relocated at 3653 Kingsway, South Burnaby. Mr. Sprinkling will be resident partner.

R. G. Wall, C.A. has been appointed supervisor of accounting for Western Canada Breweries Ltd., Vancouver.

Church, Pickard, Lane & Newman, Chartered Accountants, announce the removal of their offices to Ste. 1, 130 Third Ave. S., Port Alberni.

R. D. Thomas, B.Com., M.B.A., C.A. has joined the staff of Riddell, Stead, Graham & Hutchison, Chartered Accountants, Toronto.

### *Ontario*

Earl I. Grossman, C.A. announces the opening of an office for the practice of his profession at Ste. 214, Lawrence Plaza, 534 Lawrence Ave. W., Toronto.

Perlmutter, Orenstein, Giddens, Newman & Co., Chartered Accountants, announce the removal of their offices to 397 Dundas St., London.

John C. Ross, C.A. has been appointed secretary-treasurer of Canadian Co-operative Wool Growers Ltd., Toronto.

Hilborn & Co., Chartered Accountants, announce the removal of their offices to Canadian Pacific Bldg., 69 Yonge St., Toronto.

Geoffrey H. Ward, C.A. and Walter A. Gregory, B.A., C.A. announce the formation of a partnership for the practice of their profession under the firm name of Ward & Gregory, Chartered Accountants, with offices at Ridgeway, Ont. Mr. Ward will continue his practice at 200 Bay St., Toronto.

Geo. A. Welch & Co., Chartered Accountants, announce the admission to partnership of Weldon J. Davy, C.A. in their Cornwall office and of Robert Irvine, C.A. in their Belleville office.

Samuel S. Spencer, C.A. announces the admission to partnership of Saul S. Fox, C.A. Henceforth practice of the profession will be carried on under the firm name of Samuel S. Spencer & Co., Chartered Accountants, with offices at 4 Albert St., Toronto.

### **CHANGE OF ADDRESS**

Members and students who change their address and advise The Canadian Institute of Chartered Accountants of such change should also notify their own provincial Institute.

Periodic reconciliations of mailing lists are carried out but to ensure prompt receipt of all provincial Institute mail, it is essential that the secretary of the provincial Institute be notified directly.

## CLASSIFIED ADVERTISEMENTS

Rates: *Positions wanted, \$7.00 per column inch; Positions offered, \$10.00 per column inch; Open rate, \$17.00 per column inch.*

*All replies to box numbers should be sent to The Canadian Chartered Accountant, 69 Bloor Street East, Toronto 5, Ontario.*

**Closing date is 14th of preceding month**

**PRACTICE WANTED:** Firm of Montreal chartered accountants with clients in Toronto and vicinity wish to establish a branch office in Toronto by purchase or amalgamation. Inquiries invited. Box 600.

**OPPORTUNITY IN PUBLIC ACCOUNTING:** If you are interested in establishing your own practice in a smaller centre in Ontario in association with other practitioners, please contact G. H. Ward, Room 412, 200 Bay Street, Toronto 1. EM 4-8589. There is a very good opportunity available for a chartered accountant with the right qualifications.

**CHARTERED ACCOUNTANT WANTED:** An expanding firm of chartered accountants located in Toronto requires a young qualified man to assume supervisory responsibilities. This position offers unusual opportunities for experience and advancement. Salary commensurate with ability and experience. Box 576.

**CHARTERED ACCOUNTANT** wanted for practice in Saskatchewan with a view to partnership

or

Senior who is writing final this year. Partnership prospects on qualification. Replies to Box 587.

**CHARTERED ACCOUNTANTS:** A firm of chartered accountants in the Maritime Provinces has an opening for a chartered accountant who has received his C.A. diploma within the last five years. Applicant must be the type of person who will qualify eventually to manage a branch office and to enter into a partnership arrangement. Our staff has knowledge of this advertisement. Applications will be treated confidentially. Box 599.

**STUDENTS WANTED:** Junior, intermediate and senior students required for chartered accountants' office in Montreal. Give particulars concerning education, qualifications, experience and references. Salary accordingly. Box 598.

**CHARTERED ACCOUNTANT FIRM REQUIRES** ambitious men with good appearance. Minimum requirements junior matriculation. Senior, intermediate and junior staff required. Reply in own handwriting. Our staff is aware of this advertisement. Box 597.

**STUDENTS:** Chartered accountants require first year and intermediate students. For appointment call William Eisenberg and Company, Empire 3-6304. Toronto.



There are openings in the Accounting Department, Montreal, for recently qualified Chartered Accountants and students expecting to qualify in the 1956 examinations.

Interviews will be arranged in Toronto and Montreal on the basis of written applications. Replies giving details of education, business experience and work interests may be addressed to:

PERSONNEL OFFICE  
CANADIAN INDUSTRIES LIMITED  
P.O. Box 10, Montreal.

## SWEETNESS AND LIGHT

Since most of its readers are of the male sex, *Sweetness and Light* has never in any sense attempted to report on women's fashions. In the face of the recent crinoline fad, the sheath rage and even Bermuda shorts, it has uttered nary a peep.

However, when a fashion tornado is brewing on the horizon which, before it abates, will have blown so many holes in every husband's wallet he will think he is carrying around a sieve, the only decent democratic thing is to forewarn him.

Today women's styles are in for that kind of change — the kind that makes a wife look at her entire wardrobe and decide she has absolutely nothing to wear, and then map out a master strategy to extract from her husband the wherewithal for a new one.

The change is to the "elegant" look of the 1912 era. Milady is now going to be decked out in magnificent high-waisted gowns; the waistline will be moved up about 3 inches to cut across the diaphragm, making it quite impossible of course for her to adapt any of last year's dresses to the new style. Her hats will be of feathers or fur (for "fur" read "mink" if you are paying the bills) and around her neck

will be a lavish pearl necklace. The latter is an accessory that fashion authorities tell her she "can't afford to by-pass" though it is doubtful whether this comment is quite true from the accounting viewpoint. Her badge of identification will be a rose pinned at the neck or shoulder, and on her feet she will wear the new pointed shoes.

In an age grown too casual about the sight of women with short-cropped hair, slopping around in jeans and moccasins, the Lady, out of style since before World War I, is making a comeback and says "Fiddlesticks" to the cost.

It would be tedious to ask whether the final result is worth the expense, just as it would be useless to complain that it is all a conspiracy on the part of the Paris or New York designers. Today women are in the mood for a new fashion cycle, not having embarked on one since Christian Dior introduced his New Look in 1947. The inspiration for this latest trend comes from Cecil Beaton's prizewinning costumes for "My Fair Lady", a current Broadway musical, and women are glad to use him as an excuse. Like all cycles, this must run its course, so men might as well accept the inevitable and relax. They may console themselves with the thought that anything that keeps their womenfolk happy is money well invested, and even the shrewdest accountant dares not disagree with that statement!

JEAN VALE

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**LEMAY & ROSS****Barristers and Solicitors***132 St. James Street West - - - - - Montreal 1, Que.*

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**McMICHAEL, COMMON, HOWARD, CATE, OGILVY & BISHOP****Barristers and Solicitors***Royal Bank Building - - - - - Montreal 1, Que.*

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**PHILLIPS, BLOOMFIELD, VINEBERG & GOODMAN****Barristers and Solicitors***464 St. John Street - - - - - Montreal 1, Que.*

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**STIKEMAN & ELLIOTT****Barristers and Solicitors***505 Bank of Canada Building - - - - - Montreal 1, Que.*

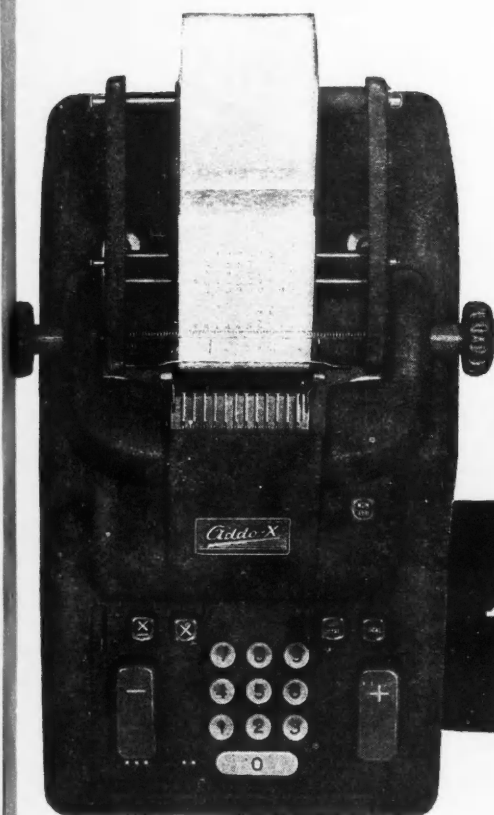
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